87 No. 1997

Supreme Court, U.S.
FILED
JUN 3 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

October Term, 1987

BLINDER, ROBINSON & CO., INC.,
and MEYER BLINDER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Whether the Due Process Clause of the Fifth Amendment permits an administrative agency that has actively litigated against a private party to be the judge, in a subsequent administrative proceeding, of the disciplinary sanction that should be imposed for the violations found during the contested litigation.

RULE 28.1 LISTING

The parent company of petitioner Blinder, Robinson & Co., Inc. is Blinder International Enterprises, Inc. Blinder, Robinson & Co., Inc. has no subsidiaries that must be listed pursuant to Rule 28.1 of the Rules of this Court.

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IN THE

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October Term, 1987

BLINDER, ROBINSON & CO., INC.,
and MEYER BLINDER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners Blinder, Robinson & Co., Inc. and Meyer Blinder respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled proceeding on January 15, 1988.

OPINION BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit is reported at 837 F.2d 1099, and is reprinted as Appendix A, pp. 1a-33a, *infra*.

The ruling of the Securities and Exchange Commission reviewed by the court of appeals is reported as *Blinder, Robinson & Co., Inc.*, Exchange Act Release No. 23913 [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,052 (Dec. 19, 1986), and is reprinted as Appendix C, pp. 35a-58a, *infra*.

JURISDICTION

The ruling of the Securities and Exchange Commission was entered on December 19, 1986. Petitioners sought review of that ruling in the United States Court of Appeals for the District of Columbia Circuit pursuant to 15 U.S.C. § 78y(a)(i). The court of appeals entered a judgment vacating the ruling and remanding the case to the Securities and Exchange Commission on grounds collateral to the issue presented in this petition. Petitioners filed a timely petition for rehearing, which was denied on March 17, 1988. *See* Appendix B, p. 34a, *infra*. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

United States Constitution, Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATEMENT

A. *Civil Injunctive Enforcement Action.*

Meyer Blinder is the chief executive of Blinder, Robinson & Co., Inc. ("Blinder-Robinson"), a nationwide broker-dealer acknowledged to be a leading underwriter of low-priced new

issues, or "penny stocks." In August 1980, the Securities and Exchange Commission ("SEC") initiated a civil enforcement action in the United States District Court for the District of Colorado, seeking an injunction against Blinder-Robinson, Meyer Blinder, and others based on allegations of securities law violations stemming from the participation of Blinder-Robinson and the individual defendants in 1979 and 1980 in a public offering of common stock and warrants by American Leisure Corporation ("American Leisure"). Blinder-Robinson and Meyer Blinder contested the action for injunctive relief.

The SEC engaged in vigorous litigation with Blinder-Robinson and Meyer Blinder in federal district court. A trial was held from July 6, 1981, to July 14, 1981. On June 8, 1982, the district court issued its memorandum opinion and order, in which it granted the SEC the entire relief it sought, namely, an injunction against future violations of the securities laws.

The defendants appealed, and on September 19, 1983, the Court of Appeals for the Tenth Circuit affirmed. *SEC v. Blinder, Robinson & Co.*, [1983-1984] Fed. Sec. L. Rep. (CCH) ¶ 99,491 (10th Cir. 1983), *cert. denied*, 469 U.S. 1108 (1985). While Blinder-Robinson and Meyer Blinder were considering whether to seek review of the Tenth Circuit's opinion by the Supreme Court, their attorneys offered to settle their dispute with the SEC. The Members of the Commission considered and rejected the settlement offer.

B. *Administrative Disciplinary Proceedings.*

While the petition for a writ of certiorari in the Tenth Circuit case was pending, the SEC initiated an administrative disciplinary proceeding under Sections 15(b) and 19(h) of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78o, 78s, against Blinder-Robinson and Meyer Blinder. The stated objective of the administrative proceeding was to determine what,

if any, disciplinary sanctions should be imposed administratively by the SEC on Blinder-Robinson and Meyer Blinder for the same violations of law previously prosecuted in the *American Leisure* civil injunctive action. During the administrative hearing, Blinder-Robinson and Meyer Blinder offered certain mitigation evidence in their defense, but the administrative law judge excluded all evidence addressed to the *American Leisure* conduct on the ground that the respondents had had their "day in court" before the federal district court that issued the injunction. The administrative law judge imposed the following sanctions: Suspension of Meyer Blinder for 90 days, provided that he not be required to divest his ownership interest in Blinder-Robinson; a consecutive two-year suspension on participation in any underwriting by Meyer Blinder; a suspension of Blinder-Robinson's registration for 45 days, and a two-year prohibition against Blinder-Robinson's participation in any underwriting. These sanctions were less harsh than the sanctions sought by the SEC's Division of Enforcement.

All parties appealed the decision of the administrative law judge to the Commission. Meyer Blinder and Blinder-Robinson challenged various legal rulings and sought a lesser sanction, and the Division of Enforcement sought more severe sanctions against Meyer Blinder. The full Commission upheld the sanctions imposed on Blinder-Robinson, but significantly increased the sanctions imposed on Meyer Blinder. It decided to bar Meyer Blinder permanently from association with any broker or dealer. With no certainty that reinstatement would ever be granted under any conditions, the SEC added that Meyer Blinder could apply for reinstatement after two years.

C. *Decision of the Court Below.*

Petitioners appealed the order of the SEC imposing sanctions on Blinder-Robinson and Meyer Blinder to the Court of Appeals for the District of Columbia Circuit on several grounds,

including that (i) the Commission's dual role as litigant and judge violated their right to due process of law and (ii) the administrative law judge improperly excluded mitigating evidence during the hearing to determine sanctions.

On January 15, 1988, the court of appeals issued its opinion agreeing with appellants that the mitigating evidence had been improperly excluded. *Blinder, Robinson & Co., Inc. v. SEC*, 837 F.2d 1099 (D.C. Cir. 1988). However, on the subject of this petition — *i.e.*, that the SEC's role as a litigant in the contested civil injunctive enforcement proceedings made it constitutionally impermissible for it to sit in the administrative disciplinary proceedings as a judge of the parties against whom it had litigated — the court of appeals found no error. The court noted that federal agencies may investigate conduct and later hear evidence and render a decision regarding that conduct (p. 14a, *infra*, citing *Withrow v. Larkin*, 421 U.S. 35 (1975)). It saw no meaningful distinction between situations where an administrative adjudication follows an agency's initiation of federal-court, as opposed to purely administrative, proceedings (p. 14a, *infra*).

D. *The Related "Books-and-Records" Case.*

The SEC is currently litigating against Blinder-Robinson and Meyer Blinder in federal district court in another civil injunctive enforcement case. On April 15, 1983, the SEC filed a complaint in the United States District Court for the District of Colorado, alleging, *inter alia*, that purported irregularities in the manner in which Blinder-Robinson maintained its books and records violated securities laws. *SEC v. Blinder, Robinson, et al.*, No. 83-K-668 (D.Colo.) ("books-and-records case"). On June 6, 1983, the district court denied the SEC's request for a preliminary injunction. The SEC nonetheless persisted with its request for a permanent injunction.

During the same period of time that the Commission was acting as adjudicator in the instant administrative disciplinary action, it was also an active litigant in its civil enforcement action against Blinder-Robinson in the books-and-records case. Thereafter, beginning in August 1987, the parties in the books and-records case became embroiled in a discovery dispute involving the right of Blinder-Robinson to depose an SEC employee designated by the SEC as an expert witness, as well as Blinder-Robinson's efforts to procure SEC records which it believed exculpatory. Despite court orders directing that the deposition take place, the SEC resisted the taking of the deposition and the production of SEC records. *See* Recommendation by United States Magistrate, December 2, 1987 (attached hereto as Appendix E, pp. 67a-79a) (detailing the history of the dispute). The resistance was the result of two votes taken by the Commission to disobey orders entered by a U.S. Magistrate, one of which was affirmed by the district court. *See* p. 74a, *infra*. The magistrate assigned to hear discovery matters in the action recommended that sanctions, including the dismissal of the complaint, be imposed against the Commission. *See* p. 78a, *infra*. The magistrate's recommendation is now pending before the district judge.

REASONS FOR GRANTING THE WRIT

1. The issue presented in this case was expressly reserved during this Court's decision in *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973), and has not been resolved in any subsequent opinion by this Court. In *Gibson*, the Alabama Board of Optometry had initiated a civil lawsuit against a corporation and the optometrists it employed. The lawsuit had resulted in a trial court judgment against the corporate defendant. Administrative proceedings were brought by the Board against the optometrists previously named by the Board as defendants. They challenged the proceedings in federal court on the ground

that, having been an adversary in civil litigation, the Board "could not provide the plaintiffs with a fair and impartial hearing in conformity with due process of law." 411 U.S. at 570.

The district court agreed that there was impermissible bias in such circumstances. It held that the Board might have "'preconceived opinions'" on the issues in the administrative proceeding because it "had previously brought suit against the plaintiffs on virtually identical charges in the state courts." 411 U.S. at 571. Accordingly, the district court enjoined the administrative agency. This Court said that the district court was "arguably" right on this ground, but this Court did not reach the question whether there had been "prejudgment of the facts" because it invalidated the Board's procedure on an alternative ground. *See* 411 U.S. at 579 & n.17.

The court of appeals in the present case has held erroneously that the issue presented here was decided by this Court in *Withrow v. Larkin*, 421 U.S. 35 (1975). In fact, *Withrow v. Larkin* did not decide the issue we presented below and are presenting here.

The central issue in *Withrow* was whether an administrative agency could temporarily suspend a license "at its own contested hearing on charges evolving from its own investigation." 421 U.S. at 42, 46. The claim in *Withrow* was that the Due Process Clause was violated by the Wisconsin Medical Examining Board's role as *investigator* and administrative adjudicator. This Court found that the combination of *investigative* and adjudicative functions in the Board, without more, did not violate due process. *See* 421 U.S. at 55. The Court observed that there is no "prejudice and prejudgment" of the outcome of an administrative proceeding if an administrative agency initially authorizes an investigation and finds probable cause to believe that there has been a statutory violation. 421 U.S. at 56-57.

Withrow v. Larkin did not concern a civil litigant who thereafter sought to act as a judge. The Wisconsin Board did not itself initiate a civil proceeding against the doctor; any court proceeding was to be started and prosecuted by the district attorney and adjudicated by a wholly independent judge. Indeed, this Court noted that the Board's participation in any prospective civil or criminal litigation was merely a "transmittal to a third party." 421 U.S. at 58-59, n.26. Nor would the Board, under the Wisconsin procedure, undertake any quasi-judicial function *after* any civil or criminal litigation resulting from its referral to the district attorney.

Contrary to the opinion of the court of appeals (p. 14a, *infra*), there is a marked difference between the involvement of the SEC Commissioners after the initiation of an administrative disciplinary proceeding and their involvement during a civil enforcement lawsuit in federal district court.[1] Because the Commission may ultimately hear an appeal and adjudicate the administrative proceeding, a wall is erected to insulate the Commissioners from that proceeding, once it has been authorized, until it comes to the Commission for a decision on the record. When the Commission is a plaintiff in a federal-court enforcement proceeding, on the other hand, the Commissioners are viewed as ordinary clients, *i.e.*, parties plaintiff. They are consulted for major decisions, status reports are provided to them, and they are called upon to decide questions of privilege and to pass on settlement offers.

In deciding whether to approve the filing of a civil enforcement action in federal court, the Commissioners review memoranda written by the staff of the Division of Enforce-

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[1]The distinctions recited in this petition are based on the affidavit of Harvey L. Pitt, Esq., formerly General Counsel of the SEC and recognized today as one of the leading experts on the SEC. The affidavit was filed with the court of appeals with our petition for rehearing. It appears as Appendix D to this petition, pp. 59a-66a, *infra*.

ment that detail the factual issues and legal theories of the case and pertinent evidentiary support for proposed factual allegations. The Commission takes up the Enforcement Division's recommendation at a closed meeting, and may hear extended discussion regarding any and all facets of the proposed injunctive action.

Furthermore, in civil actions, the Commissioners are interested parties and, as such, are kept advised of major developments in the cases. In administrative disciplinary proceedings, on the other hand, the Commissioners are not advised of the staff's activities in connection with the proceedings, except to the extent they receive such information in their capacity as judges. Commissioners have influence over the course and direction of the proceedings in civil district-court actions, but have no influence over administrative proceedings until the case reaches them on appeal.

Moreover, certain issues that arise in civil district court lawsuits must be resolved by the Commissioners themselves as parties plaintiff, such as whether to invoke a privilege, whether to appeal a result that is adverse to the Commission's position, and whether to abandon certain claims at trial or to amend a complaint to add new claims. Such issues are not brought to the Commission if they arise in administrative proceedings because the Commission is the appellate tribunal before which the disciplinary proceeding pends, and it must remain impartial. Prohibitions against *ex parte* contacts are strictly enforced while an administrative proceeding is pending, but are considered inapplicable to district court civil suits. The net effect of these differences is that the Commission's actions in administrative disciplinary proceedings are consistent with its judicial function, but its actions after it initiates a civil lawsuit are consistent with its adversarial function as a party plaintiff.

In the instant case, therefore, there was much more than investigation by the agency, as there had been in *Withrow v. Larkin, supra*. The SEC also concluded that the case deserved to be filed in court. It participated in the development of litigation strategy. It joined, as a party plaintiff, in the vigorous prosecution of the case. And it reviewed and rejected a settle ment offer by the petitioners.

Indeed, the adversarial nature of the SEC's role in litigation against Blinder-Robinson and Meyer Blinder is well demonstrated by the parallel books-and-records case. At the time that the Commission was considering the appeal of the administrative law judge's order in the instant American Leisure case, it was making litigation decisions as party plaintiff in the books-and-records action. As is detailed in the magistrate's recommendation in the books-and-records case, p. 68a-71a, *infra*, the SEC has been a recalcitrant litigant. Sanctions were imposed, and severe additional sanctions have been proposed, on the SEC as the result of motions filed by the same parties whom the SEC judged in this case.[2]

This case thus presents a very different question from the issue decided in the *Withrow* case. The issue reserved in *Gibson v. Berryhill, supra*, was the constitutionality of a procedure whereby the agency "had filed a complaint in state court" and the complaint's charges "were substantially similar to those pending against appellees before the Board." 421 U.S. at 578. That issue — the authority of a litigant to become a judge — was not involved or decided in *Withrow*. The Court

[2]For example, the SEC made several eleventh-hour motions designed to delay or prevent the taking of a contested deposition. As a result of one such motion, the court granted sanctions in the form of attorneys' fees to Blinder-Robinson. *See* p. 70a, *infra*. The litigation strategy decisions to delay or prevent the deposition were not decisions made merely by the Enforcement Division, but were plainly made by the Commission itself. *See* p. 74a, *infra*.

should review this case to decide the issue reserved in *Gibson v. Berryhill.*

2. The decision below also conflicts with decisions of this Court. The unconstitutionality of the procedure followed here by the SEC was established in *In re Murchison*, 349 U.S. 133 (1955). The Court held in *Murchison* that the Due Process Clause is violated by a procedure whereby an individual who conducts an investigation and makes an accusation subsequently sits in judgment on the allegations growing out of that investigation. The Court said, "[N]o man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome." 349 U.S. at 136

The "interest" that forecloses a judicial role need not be a financial one, and may merely be the personal interest that develops from being part of the accusatory process. For, as the Court observed in *Murchison,* "[h]aving been a part of that process a judge cannot be, in the very nature of things, wholly disinterested in the conviction or acquittal of those accused." 349 U.S. at 137.

The *Murchison* court acknowledged that there was no proof of actual bias in the record of that case, and it conceded that its "stringent rule" of constitutional law might bar judges "who would do their very best to weigh the scales of justice equally between contending parties." 349 U.S. at 136. But, said the Court, allowing a prosecutor to become a judge would offend the "appearance of justice" requirement that is part of the constitutional obligation of Due Process. *See Offutt v. United States*, 348 U.S. 11, 14 (1954).

The importance of maintaining total disinterestedness and objectivity in quasi-judicial determinations has also been emphasized by this Court in other contexts. *See, e.g., Morrissey v. Brewer*, 408 U.S. 471, 485-86 (1972), where this Court

held that "[t]he officer directly involved in making recommendations cannot always have complete objectivity in evaluating them." 408 U.S. at 486 (footnote omitted). *See also Young v. United States ex rel. Vuitton*, 107 S. Ct. 2124 (1987), where the Court invalidated a procedure under which the attorney for a civil plaintiff was judicially appointed as the prosecutor for criminal contempt proceedings based on alleged violations of a court injunction. The Court held that such an appointment "at a minimum created *opportunities* for conflicts to arise, and created at least the *appearance* of impropriety." 107 S. Ct. at 2137 (emphasis in the original).

In the administrative disciplinary proceedings involving these petitioners, the Commission sought to impose severe sanc tions such as the lifetime bar from the securities business and divestment of stock ownership ordered against Meyer Blinder and the 90-day business suspension and two-year underwriting bar imposed against Blinder-Robinson. These are punitive as well as remedial in nature. *See Beck v. SEC*, 413 F.2d 832 (6th Cir. 1969), *after remand*, 430 F.2d 673 (6th Cir. 1970); *Klopp v. SEC*, 427 F.2d 455 (6th Cir. 1970); *Collins Securities Corp. v. SEC*, 562 F.2d 820 (D.C. Cir. 1977); *Kivitz v. SEC*, 475 F.2d 956 (D.C. Cir. 1973).

Finally, the constitutional bar against the transformation of a litigant into a judge is not limited to instances in which the same human being fills both roles. To be sure, several of the decided cases, including *Murchison*, have concerned individuals whose judicial impartiality has been questioned in light of their own prior participation in litigating the same or related cases. *E.g., American General Ins. Co. v. FTC*, 589 F.2d 462 (9th Cir. 1979); *Cinderella Career and Finishing Schools, Inc. v. FTC*, 425 F.2d 583 (D.C. Cir. 1970); *Amos Treat & Co. v. SEC*, 306 F.2d 260 (D.C. Cir. 1962); *Trans World Airlines, Inc. v. CAB*, 254 F.2d 90 (D.C. Cir. 1958).

But the rule extends, as well, to a collective body or agency that has been involved as a party and would benefit institutionally from a favorable ruling. Indeed, the classic case applying the rule that one cannot be a judge and a party in the same case involved an institution, England's Royal College of Physicians. In *Dr. Bonham's Case*, 8 Eng. Rep. 114a, 118a (Com. Pl. 1610), Lord Coke held that the Royal College could not discipline a doctor if the College had the right to receive any part of his fine. *See also City of London v. Wood*, 12 Mod. 669, 687 (1701) ("[I]t is against all laws that the same person [*i.e.*, the City of London] should be party and Judge in the same cause").

3. This petition raises an important issue concerning the denial of procedural fairness by a governmental body that first litigated and then tried to sit in judgment on the same facts with respect to the same parties. The procedure employed in this case by the SEC is no isolated occurrence. It is a normal practice of the SEC to follow the course at issue here — to seek an injunction as a litigant and then to enter judgment as an adjudicator in a parallel or subsequent administrative disciplinary proceeding. This issue presents a widespread administrative practice whose legitimacy should be resolved. Moreover, the District of Columbia Circuit's opinion is likely to affect a large number of parties in litigation with the SEC because much of the litigation involving the SEC is brought in the District of Columbia Circuit.

This is not an attack on the constitutionality of the Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.* ("APA"). The APA provides procedures for agencies to follow in investigating, prosecuting, and adjudicating administrative actions. It does not explicitly or impliedly authorize an agency to initiate court litigation and thereafter to sit in judgment of its litigation adversary in related administrative proceedings.

Petitioners' quarrel is not with the APA but with the process utilized by the SEC that was not prescribed by the APA and that violates petitioners' constitutional right to due process of law.

4. The petition should be granted even though the effect of the decision by the court below is not to conclude the case but to remand for further proceedings. This Court has, on occasion, denied writs of certiorari because the decision below merely remanded the case to a trial court or an agency. *E.g.*, *Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostock R. Co.*, 389 U.S. 327 (1967). In this case, however, the entire remanded proceeding is constitutionally defective because of the issue raised in this petition. The petitioners should not be required to stand trial, even on remand, before an agency that has prejudged their case.

Review is appropriate because the issue presented is of fundamental importance.[3] In *United States v. General Motors Corp.*, 323 U.S. 373 (1945), this Court granted certiorari despite the fact that the court of appeals had remanded the case to the district court for a trial in accordance with its ruling. The Court said, "We think we should review that ruling inasmuch as it is fundamental to the further conduct of the case." 323 U.S. at 377. This Court has reviewed other cases remanded by courts of appeal for the same reason. *See, e.g.*, *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 n.3 (1949); *Land v. Dollar*, 330 U.S. 731, 734 n.2 (1947). Whether the SEC may constitutionally impose administrative disciplinary sanctions on its former opponent in litigation, for the same conduct as was contested in the prior litigation, is a constitutional question of great significance. If it is decided

[3]The court of appeals has passed on the constitutionality of the procedure employed by the SEC in this case. No future decision by the SEC will alter its judgment on that question.

in petitioners' favor, no further proceedings should be held before the SEC.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 3, 1988

APPENDIX A

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 87-1080

BLINDER, ROBINSON & CO., INC., PETITIONER

v.

SECURITIES & EXCHANGE COMMISSION, RESPONDENT

No. 87-1086

MEYER BLINDER, PETITIONER

v.

SECURITIES & EXCHANGE COMMISSION, RESPONDENT

Petition for Review of an Order of the Securities and Exchange Commission

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Argued November 3, 1987

Decided January 15, 1988

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

Arthur F. Mathews, with whom *David M. Becker*, *Andrew B. Weissman*, *David D. Rosskam* and *Karen A. Getman* were on the brief, for petitioner Blinder, Robinson & Co., Inc.

Nathan Lewin, with whom *Jonathan B. Sallet* and *Mary L. Lyons* were on the brief, for petitioner Meyer Blinder.

Jacob H. Stillman, Associate General Counsel, Securities and Exchange Commission, and *Rosalind C. Cohen*, Assistant General Counsel, Securities and Exchange Commission, with whom *Daniel L. Goelzer*, General Counsel, Securities and Exchange Commission, *Paul Gonson*, Solicitor, and *Thomas L. Reisenberg*, Senior Special Counsel, Securities and Echange Commission, were on the brief, for respondent.

Before: RUTH B. GINSBURG and STARR, *Circuit Judges*, and GESELL,* *District Judge*, United States District Court for the District of Columbia.

Opinion for the Court filed by *Circuit Judge* STARR.

Concurring opinion filed by *Circuit Judge* RUTH B. GINSBURG.

STARR, *Circuit Judge*: These petitions for review challenge an order by the Securities and Exchange Commission imposing sanctions on a registered broker-dealer and its president and principal shareholder. The petitioners advance a number of contentions, both constitutional and nonconstitutional in nature. For the reasons that follow, we vacate the Commission's order and remand the case for further proceedings.

I

This litigation pits the SEC against Blinder, Robinson & Co. (and its principal), a leading broker-dealer in the genre of securities known as "penny stocks." The action

* Sitting by designation pursuant to 28 U.S.C. § 292(a).

arose out of an investigation into the actions of Blinder, Robinson and its president, Meyer Blinder, in underwriting an initial public offering of securities of American Leisure Corporation between December 1979 and March 1980. The purpose of the offering was to provide start-up funds for American Leisure's proposed casino project in Atlantic City. In the course of the offering, Blinder, Robinson took a variety of steps destined to be challenged by the SEC. In particular, the Commission assailed Blinder, Robinson's undisclosed purchase for its own account of almost 1 million units of the 12-million unit offering;[1] a host of other violations were alleged as well, including violations of the antifraud provisions of both the Securities Act of 1933 and the Securities Exchange Act of 1934.

Based on these allegations, the Commission brought a civil enforcement action pursuant to its statutory authority under section 20(b) of the 1933 Act, 15 U.S.C. § 77t (b) (1982), and section 21(d) of the 1934 Act, 15 U.S.C. § 78u(d), against both Blinder, Robinson and Meyer Blinder in the United States District Court for the District of Colorado. After a full trial, the district court entered findings of fact and conclusions of law, which are reported at 542 F. Supp. 468 (D. Colo. 1982). The comprehensiveness of the district court's thorough and careful opinion renders it unnecessary for us to recanvass the underlying facts. It suffices for present purposes to observe that the district court in Colorado found that (1) both Blinder, Robinson and Meyer Blinder had violated the antifraud provisions of the securities laws, 15

[1] The American Leisure offering was on "all or none" terms. "All or none" transactions are ones in which funds paid for stocks by buyers are placed in escrow until a certain date; if the entire offering is not sold out by that date, the deal is cancelled, and the escrowed monies returned. The SEC thus viewed the company's buying for its own account as highly misleading, as it gave the impression that the offering was progressing successfully when it in fact was not.

U.S.C. 77q(a), 78j(b), 78o(c) and various rules promulgated thereunder, including Rule 10b-5; (2) the defendants had failed to establish a claimed defense of good-faith reliance on counsel and that, to the contrary, the firm had refused to follow the advice of counsel; and (3) comprehensive injunctive relief was appropriate, as articulated in nine specific subparagraphs set forth in 542 F.Supp. at 481-82.

Blinder, Robinson and Meyer Blinder took an appeal to the Tenth Circuit, which in due course affirmed entirely the district court's judgment. *SEC v. Blinder, Robinson & Co., et al.* [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,491 (10th Cir. 1983). The Supreme Court thereafter denied certiorari. 469 U.S. 1108 (1985).

As the foregoing litigation was proceeding through the appellate process, the SEC instituted an *administrative* proceeding against Blinder, Robinson and its president pursuant to section 15(b)(4) of the 1934 Act, 15 U.S.C. 78o(b)(4). That provision authorizes the Commission to impose sanctions on broker-dealers if, after notice and hearing, it determines that sanctions are in "the public interest." The stated purpose of the proceeding was to determine what sanctions, if any, to impose on petitioners by virtue of their conduct during the American Leisure underwriting.[2] *See* Order for Public Proceedings and Notice of Hearing (June 27, 1984), *reprinted in* Joint Appendix (J.A.) at 30.

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[2] The order provided in pertinent part:

> [T]he Commission deems it necessary and appropriate in the public interest and for the protection of investors, that public proceedings be instituted to determine:
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> . . .
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> B. What, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b) and 19(h) of the Exchange Act.

J.A. at 34.

In due course, a hearing ensued before an Administrative Law Judge. At the outset, the ALJ determined that petitioners could not, under principles of issue and claim preclusion, introduce evidence as to any matters addressed in the district court's opinion. Blinder, Robinson describes its fruitless efforts in this respect as follows:

> First, petitioners sought to elicit testimony from Meyer Blinder concerning his reliance on counsel. Second, petitioners sought to introduce oral testimony from one of the principal attorneys concerning the advice to Meyer Blinder. When these requests were denied, petitioners sought to introduce into the record all evidence concerning reliance on counsel that had been before the District Court in the injunctive proceeding. This request, too, was denied.

Brief for Petitioner Blinder, Robinson & Co. at 7-8 (footnotes omitted.)

Largely rejecting petitioners' claims that the firm had undertaken "substantial rehabilitative efforts to ensure that the American Leisure events would not be repeated," *id.* at 9, the ALJ concluded that sanctions should be imposed. Specifically, the ALJ ordered that Blinder, Robinson's registration be suspended for 45 days and that a two-year ban be imposed on Blinder, Robinson's underwriting activities; as to Meyer Blinder, the ALJ concluded that he should be suspended from association with any broker or dealer for a period of 90 days. The ALJ put it this way:

> In light of the egregiousness of the antifraud and antimanipulation violations found in the *American Leisure* injunction opinion . . . coupled with the failures of Respondents to establish in the main their claims to fullsome rehabilatative [sic] actions and to a new and genuine dedication to compliance. . . . it is concluded that substantial sanctions . . . are . . . in the public interest, but that sanctions of the severity recommended by the [Enforcement] Division are not

> required in light of the mitigative factors found herein, including the remedial steps actually taken.
> . . .

Initial Decision (Aug. 30, 1985), J.A. at 517-L.

Neither petitioners nor the SEC staff were enamored of the ALJ's decision. Both sides therefore appealed to the full Commission. In the order from which review is now sought, the SEC upheld the ALJ's decision and choice of sanctions as to Blinder, Robinson, but increased the sanctions imposed on Meyer Blinder individually, determining that he should be barred permanently from association with any broker or dealer (with the proviso that he could apply for reinstatement after two years). *See* Opinion of the Commission (Dec. 19, 1984), J.A. at 536. In a detailed opinion, the SEC made the following points, among others: (1) petitioners' claims of rehabilitation and reformation were unpersuasive, as evidenced by "wholly misleading" sales presentations and techniques still employed by the firm, J.A. at 547-48; (2) the firm's much vaunted personnel changes since the American Leisure imbroglio were entitled to "little weight," in view of key employees having been beguiled away from Blinder, Robinson by the enticing bid of a competing firm, as well as the tell-tale continuing presence of three high-ranking officers with disciplinary records, and, most importantly, of the firm's continued dominance by Meyer Blinder himself, *id.* at 549; and (3) the sanctions imposed by the Commission, while stringent, were necessary to guard against "any repetition of the blatant misconduct in which respondents engaged." *Id.* at 550.

The Commission expressly recognized the gravity of its decision:

> We recognize the serious effect of the sanctions we are imposing. But we are convinced that lesser sanctions will not suffice. Our action is designed to protect the public interest not only by restricting respondents' future activity in the securities business

> but also by deterring them from any repetition of their violative practices. The sanctions are a clear message to registrant, and to Blinder if and when he returns to the securities business, that any recurrence of misconduct will be dealt with severely. At the same time, the sanctions serve the important purpose of general deterrence, and should operate as a warning to any other participant in the securities industry who might be tempted to engage in similar misconduct.

Id. at 550 (citation omitted.)[3]

On New Year's Eve 1986, the Commission entered a stay with respect to the sanctions imposed on Blinder, Robinson. J.A. at 553-56. Applying the criteria articulated by this court, *see, e.g., Wisconsin Gas Co. v. FERC*, 758 F.2d 669, 673-74 (D.C. Cir. 1985); *Washington Metro. Area Transit Comm'n v. Holiday Tours, Inc.*, 559 F.2d 841, 844 (D.C. Cir. 1977), the Commission denied Meyer Blinder's request for stay. On March 26, 1987, this court, over the opposition of the SEC, entered an order staying the entry of sanctions against Meyer Blinder. *See* Brief for Petitioner Blinder, Robinson & Co. at 10 n.28.

II

Petitioners assert a variety of grounds for overturning the SEC's order. For ease of discussion, their contentions can be divided into two categories, those arising under the Constitution, and other, nonconstitutional, claims.

A

1. *Separation of Powers*

In their broadest line of attack, petitioners contend that the SEC lacked power under the Constitution to seek in federal district court the injunction that pro-

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[3] The reference to Mr. Blinder's possible return to the securities business took into account the Commission's proviso that he could apply for reassociation after two years.

vided the foundation for the set of administrative sanctions that the Commission ultimately fashioned. In petitioners' view, an independent agency whose members are secure from removal at the President's will is constitutionally disabled from bringing law enforcement actions, a function entrusted to the Executive under Article II of the Constitution. We decline to entertain this aspect of petitioners' challenge, however, by virtue of the fact that petitioners have previously litigated (and lost) this very issue in the federal district court in Colorado, the appeal of which is currently pending in the Tenth Circuit.

The well-established policies underlying preclusion of relitigation are especially applicable here. The waste of judicial resources would be particularly stark were we to allow petitioners to have another day in court on this question. Two separate Courts of Appeals are being asked to resolve the very same issue, presented by the very same parties, on a single set of facts. We therefore defer to our colleagues in the Tenth Circuit, inasmuch as the issue was first presented, and has been initially resolved, in that circuit. *See Durfee v. Duke*, 375 U.S. 106 (1963) (when first court's jurisdiction is actually litigated, a subsequent court must give the first court's resolution preclusive effect); *Stoll v. Gottlieb*, 305 U.S. 165 (1938) (same).[4]

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[4] *Chicot County Drainage Comm'n v. Baxter State Bank*, 308 U.S. 371 (1940), cited by the SEC as support for applying the normal rules of preclusion in this case, is in our view a more difficult case than the present one. In *Chicot County*, the Supreme Court gave preclusive effect to a prior judgment, notwithstanding the fact that the prior court's jurisdiction had been based upon a statute later found to be unconstitutional. The case dealt with a bondholder's suit to recover the value of his defaulted bonds, even though in a prior bankruptcy proceeding a court had effected a reorganization plan (to which the party had notice) which disposed of the issuer's obligations; the constitutionality of the bankruptcy act, and therefore the court's jurisdiction, were not

Petitioners suggest that relitigation is appropriate where, as here, the prior court's jurisdiction is at issue. Under those circumstances, petitioners argue, the court's resolution of the issue is open to collateral challenge, citing *Kalb v. Feuerstein*, 308 U.S. 433 (1940), and *United States v. U.S. Fidelity Co.*, 309 U.S. 506 (1940), in support of their position. We disagree. Properly read, both *Kalb and U.S. Fidelity* stand narrowly for the propositions that collateral attack is permitted only when the first court's proceeding "substantially infringe[d] the authority of another tribunal or agency of government," Restatement (Second) of Judgments § 12(2) (1982), or when it improperly trenched on sovereign immunity.[5] The present case is, in our view, unexceptional; having fully litigated (and lost) in Colorado, petitioners, have no persuasive claim to a second try.[6]

For the foregoing reasons, we conclude that precedent supports, and sound policies informing the orderly administration of justice demand, our not entertaining petitioners' constitutional challenge to the SEC's civil enforcement power.

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questioned in the first proceeding. The statute on which the bankruptcy proceeding had been founded was later found, in an unrelated case, to be unconstitutional. By contrast to *Chicot County*, in the present case, as in *Durfee v. Duke* and *Stoll v. Gottlieb*, the first court's jurisdictional power was contested and actually decided.

[5] In *Kalb*, a state court had exercised jurisdiction over a foreclosure action, even though federal bankruptcy law vested exclusive jurisdiction in the federal courts. In *U.S. Fidelity*, a federal court had issued a judgment requiring certain Indian Nations to pay monies on disputed bonds, in contravention of their sovereign immunity. In both cases, the Supreme Court refused to give the judgments preclusive effect in subsequent suits.

[6] We note that the fact that a judgment is pending on appeal ordinarily does not detract from its finality (and therefore its preclusive effect) for purposes of subsequent litigation. *See Martin v. Malhoyt*, 830 F.2d 237, 265 (D.C. Cir. 1987), and authorities cited therein.

2. *Due Process*

In addition to petitioners' jointly advanced separation-of-powers argument, Meyer Blinder argues, separately, that the procedures employed by the SEC and its staff in this dispute run afoul of the Fifth Amendment's Due Process Clause. As Mr. Blinder sees it, the SEC's repairing first to federal court, vigorously litigating against him in that forum, and thereafter imposing Commission-spawned administrative sanctions on him cannot stand in the face of the bedrock constitutional requirement of procedural fairness. Here is the way Mr. Blinder summarizes his claim:

> Having prevailed on its contested lawsuit, the SEC now is seeking to exercise quasi-judicial discretion to decide how severely Mr. Blinder should be sanctioned for the conduct that was the subject of the lawsuit. If the Commission's proposed course is permitted, a plaintiff will have become a judge of its own claim.

Brief for Petitioner Meyer Blinder at 13.

Invoking a line of cases illustrated by the Supreme Court's decision in *In re Murchison*, 349 U.S. 133 (1955), which we shall discuss presently, Mr. Blinder maintains that the Constitution "does not permit . . . a transformation of litigation roles" so as to permit a litigant to become a judge in its own case. Brief for Petitioner Meyer Blinder at 13. The infirmity in the SEC's procedures in this instance, Blinder complains, is exacerbated by three additional factors: first, the SEC chose in the first instance to eschew administrative procedures and to resort initially to federal district court, a forum which granted substantial relief to the Commission and which remains available for any agency request for further relief; second, the prejudice wreaked by the SEC's "doffing its litigator's hat" and "donning judicial robes" is especially "acute when the agency, as litigant, has considered and rejected a settlement offer," *id.* at 14; and third, the

likelihood of injustice (and its appearance) is "aggravated when the agency continues to engage in active litigation with the party whom it is judging." *Id.*

We disagree with Mr. Blinder's analysis. In our view, his approach represents, upon reflection, not merely a narrow attack on the specific procedures employed in his case. Rather, Mr. Blinder's challenge, fairly viewed, represents nothing less than an assault on the constitutionality of a principal feature of the Administrative Procedure Act itself. That familiar statute, enacted by Congress over forty years ago, represents a comprehensive charter for the conduct and operation of modern administrative agencies. Among other things, the APA prohibits agency staff from combining prosecutorial and adjudicative functions in the same case. 5 U.S.C. § 554(d) (1982). *But it expressly exempts agency members from this prohibition of combined functions. Id.*

The permissibility of the APA-sanctioned regime under the Constitution has been strongly suggested (if indeed not settled) by the Supreme Court in the case of *Withrow v. Larkin*, 421 U.S. 35 (1975). There, in recognizing the substantiality of arguments challenging the combination of functions or purposes in a single individual or body, the Court observed that "legislators and [commentators] have given much attention to whether and to what extent distinctive administrative functions should be performed by the same persons. No single answer has been reached. Indeed, the growth, variety, and complexity of the administrative process have made any one solution highly unlikely." *Id.* at 51. With this recognition of the problem, the Court, speaking through Justice White, went on to state:

> Congress has addressed the issue in several different ways, providing for varying degrees of separation from complete separation of functions to virtually none at all. For the generality of agencies, *Congress has been content with section 5 of the* [*APA*], *which*

> *provides that no employee [may combine functions], but which also expressly exempts from this prohibition "the agency or a member or members of the body comprising the agency."*

Id. at 51-52 (citations and footnotes omitted) (emphasis added).

In its discussion of applicable precedent, the *Withrow* Court carefully distinguished Mr. Blinder's featured case, *In re Murchison*. At issue in *Murchison* was the constitutionality of a Michigan law authorizing a judge of any court of record in the State to act as a one-man grand jury. Faced with this unusual statute, the Supreme Court found a due process violation in Murchison's conviction before a judge who tried him for contempt arising out of his, Murchison's, testimony before the same judge acting as a one-man grand jury. The basic teaching of *Murchison* was this:

> A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome.

349 U.S. at 136.

Interpreting this broad statement, the Court in *Withrow* expressly distinguished the situation of administrative agencies from the prototypical situation of a judge performing combined functions. "*Murchison* has not been understood," the *Withrow* Court stated, "to stand for the broad rule that the members of an administrative agency may not investigate the facts, institute proceedings, and then make the necessary adjudications." 421 U.S. at 53. Indeed, Justice White continued, "[t]he [*Murchison*] Court did not purport to question . . . the Administrative Procedure Act." *Id.*

Withrow's qualification of *Murchison*'s broad teaching is further illustrated by the Court's treatment of one factual twist in *Withrow* itself. The facts of *Withrow*, briefly stated, were these: one Dr. Larkin had obtained a license to practice medicine in Wisconsin from a state-created Examining Board, composed of practicing physicians. In due course, the Examining Board sent Dr. Larkin a notice that it would hold an investigative hearing, as authorized under state law, to determine whether he had engaged in certain proscribed acts. In the notice, the Board indicated that, based on the evidence to be presented at the investigative hearing, the Board would then decide what action to take, including possibly referring the matter for criminal prosecution or instituting license revocation proceedings.

Dr. Larkin promptly filed an action in federal district court challenging the Board's procedures as violative of the Due Process Clause under the *Murchison* line of authority. In the course of that litigation, the Board was enjoined by the trial court from going forward with its proposed hearing. Faced with that order, the Board went forward, albeit without a hearing, and issued formal findings of fact and conclusions of law that probable cause existed to believe Dr. Larkin had violated state law. The findings were then forwarded to the state prosecutor for possible prosecution.

In addressing this aspect of the Board's course of action, the *Withrow* Court flatly rejected the contention that this particular tack showed bias or prejudice on the part of the Board. The Court once again invoked the administrative agency model in language that bears directly on the question Mr. Blinder brings before us:

> It is also very typical for the members of administrative agencies to receive the results of investigations, to approve the filing of charges or formal complaints instituting enforcement proceedings, and then to participate in the ensuing hearings. *This mode of*

> *procedure does not violate the Administrative Procedure Act, and it does not violate due process of law.*

Id. at 56 (footnote omitted) (emphasis added).

Withrow v. Larkin thus stands as a formidable (if not insurmountable) barrier to Mr. Blinder's due process attack. Undaunted, Mr. Blinder seeks to avoid *Withrow*'s pronouncements by suggesting its inapplicability where, as here, the agency chooses first to litigate in federal court, rather than instituting administrative proceedings. We are at a loss to discern a meaningful distinction in the suggested difference. Whether the adversarial proceeding is before an agency-designated ALJ or a federal district court judge, the relationship obviously remains one of adversariness between agency and opponent. Indeed, if anything the difference cuts against Mr. Blinder's position, because he was afforded the not insubstantial advantage of the neutral forum provided by an Article III court, with its attendant procedures and protections (including the rules of evidence and procedure) that may not obtain in an agency adjudication.[7]

Nor does the fact that the Commission considered and rejected Mr. Blinder's offer of settlement alter our analysis. Offers of settlement are in the very nature of the litigation process; common experience tells us that neither consideration nor rejection of an offer of settlement contains within it the inherent likelihood of bias and

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[7] Mr. Blinder suggests that when the SEC engages in highly publicized litigation of the sort that ensued in Colorado, the resultant placing of "institutional prestige" on the line impermissibly adds to the appearance, if not actuality, of injustice. We reject this argument as well. The concept of "institutional prestige" relied on by petitioners is in severe tension with fundamental premises of the administrative state. One of those premises is that *institutions* may competently perform diverse functions. At the agency level, our law assumes integrity in individual members, and requires direct evidence of bias, or some other personal interest, to overcome that assumption.

prejudice. Settlement offers are rejected day in and day out for a multitude of reasons; but rejection of a settlement offer does not suggest prejudgment, much less bias, on the part of an administrative agency. If in *Withrow v. Larkin* the Examining Board's issuance of formal findings of fact and conclusions of law did not suffice to establish bias, then the SEC's rejection here of a settlement offer is even farther away from constitutionally forbidden territory.

Our conclusion in this respect is reinforced by (but by no means conditioned on) the fact that, as Mr. Blinder describes it, only one Commissioner who participated in the order imposing sanctions had participated in the earlier consideration and rejection of the settlement offer. It would be a strange rule indeed that inferred bias on such a tenuous basis, and then presumed that the bias spread contagion-like to infect Commissioners who were not even called upon to consider the settlement offer. To do so would manifest profound disrespect for Congress' deliberately structuring agencies as (typically) multi-member bodies, with staggered terms and with requirements that the President appoint a certain number of members from the political party other than his own. To give credence to Mr. Blinder's dark suspicion of bias notwithstanding this carefully crafted structure would flout what Justice White, in writing for the Court in *Withrow*, called "a presumption of honesty and integrity" on the part of those who serve in office. *Id.* at 47.[8]

In short, we believe that Mr. Blinder has failed to heed *Withrow*'s message that a due process challenge directed

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[8] Blinder's argument that the SEC must be biased as it continues in litigation with him is but another chapter of the same book. The foundation of his argument is flawed for the reasons already given in the text; the mere fact that litigation goes on hardly suggests that the Commissioners, with their broad ranging areas of responsibility over the wide world of securities markets, have succumbed to bias and prejudice against a single firm and its president.

broadly to combinations of purposes or functions in the modern administrative state "assumes too much." *Id.* at 49. As in *Withrow* itself, acceptance of Mr. Blinder's broad due process attack would transmogrify the sensible holding of *Murchison*,[9] and in the process accede precisely to what the Supreme Court has twice warned against, namely a sweeping due process challenge that " 'would bring down too many procedures designed, and working well, for a governmental structure of great and growing complexity.' " *Id.* at 49-50, *quoting Richardson v. Perales*, 402 U.S. 389, 410 (1971).

Mr. Blinder argues, finally, that the district court in Colorado remains open for the SEC to seek any relief in addition to that which it previously sought and secured in that forum. This is, upon analysis, a policy argument, not one sounding in due process. This is particularly true in the circumstances of this case, where the SEC did not seek to obtain specific sanctions (save for injunctive relief) in district court against Mr. Blinder and his firm. The subsequent administrative proceeding therefore does not, fairly viewed, constitute a second bite at the apple for an agency that had failed to convince an Article III judge of the merits of a particular remedy. Instead, based upon the district court's judgment, the SEC subsequently initiated procedures expressly ordained by Congress in section 15(b)(4). This, we are satisfied, does not run afoul of any values of fundamental fairness

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[9] We set aside as inapplicable those cases involving a possible financial interest on the part of a decisionmaker. *See, e.g., Gibson v. Berryhill*, 411 U.S. 564 (1973) (which expressly reserved the issue subsequently addressed in *Withrow v. Larkin*). Indeed, the great English case cited by Mr. Blinder, *Dr. Bonham's Case*, 8 Eng. Rep. 114a (Com. Pl. 1610), involved just such a financial interest. There, in a memorable opinion by Lord Coke, the Royal College of Physicians was prevented from disciplining a doctor if the College had the right to receive any part of the fine. While edifying, *Dr. Bonham's* case and its progeny have no bearing on the issue before us.

embodied in the Due Process Clause. Indeed, to accept petitioners' broadside would do violence to the core value of flexibility (coupled with appropriate procedural protections) that has been the hallmark of the modern administrative process.

Indeed, a moment's reflection suggests that acceptance of Mr. Blinder's claim under the Due Process Clause would do considerable violence to Congress' purposes in establishing a specialized agency to regulate in the difficult and challenging world of financial markets and securities regulation. Ironically, the wisdom of Congress' handiwork is suggested by the brief of Mr. Blinder's own firm, whose words, we believe, aptly capture the considerations informing Congress' policy choice in this respect:

> While courts are best equipped to adjudicate whether statutory violations occurred, Congress believed the SEC's particular expertise would best enable it to choose among available administrative disciplinary sanctions and to discern the interests of the investing public.

Blinder, Robinson Brief at 43 (footnote omitted).

In sum, to accept Mr. Blinder's argument would be to work a revolution in administrative (not to mention constitutional) law, in the face of repeated cautionary signals from the Supreme Court. We decline the invitation to storm the barricades and, instead, content ourselves with following what seems to us the clear teaching of the Supreme Court that a fundamental aspect of the modern administrative state is not founded upon a violation of the Due Process Clause.

3. *Fourth Amendment*

Blinder, Robinson devotes a few pages of its brief to the proposition that the SEC's disciplinary sanctions are infected with an underlying Fourth Amendment violation and thus cannot stand. As we understand the point, Blinder, Robinson maintains that the Formal Order of

Investigation which led to the initial district court proceeding was unconstitutionally broad. This order, employed by the staff over 17 months after its issuance as the basis for investigating the American Leisure offering, "constituted a broad warrant supposedly authorizing the SEC staff to undertake an investigation, with administrative subpoena power, of a virtually unlimited range of conduct by Blinder, Robinson over an open-ended period of time." Blinder, Robinson Brief at 35. Blinder, Robinson condemns the investigative order as a general grant of surveillance power over the entirety of the firm's activities for an indefinite period of time. This, Blinder, Robinson complains, cannot be countenanced under the Fourth Amendment.

So framed, the argument appears to be an attack on the validity of the Colorado district court injunctive proceeding. And indeed, so it is. As such, it is doomed to fail, for even if the 1978 Formal Order could be viewed somehow as constituting an intrusion for purposes of Fourth Amendment analysis, a proposition which we need not address and with which the Commission emphatically disagrees, we will not entertain this untimely collateral attack on the Colorado proceedings. Those proceedings provided the time and the place for advancing any such claims of illegality; it is simply too late in the day to litigate issues that could have been adjudicated in the courts of the Tenth Circuit. Indeed, the record in this hydra-headed litigation reflects that the issue was in fact litigated by Blinder, Robinson in a separate action brought against the Commission and its staff, seeking injunctive and other relief on account of asserted Fourth Amendment violations. That action, the procedural history of which is described in one of the Tenth Circuit's opinions in this litigation, *Blinder, Robinson & Co., Inc. v. SEC*, 748 F.2d 1415, 1417-18 (10th Cir. 1984), indicates that twelve days before the SEC filed its complaint in federal district court in Denver, Blinder, Robinson and Mr. Blinder repaired to the same court in an

attempted preemptive strike. That litigation ultimately ended with a whimper, namely an appellate determination of mootness, *see id.* at 1418-19. But in the process of resolving that branch of the litigation, the Tenth Circuit squarely rejected petitioners' efforts to litigate the question of the legality of evidence secured pursuant to subpoenas issued under authority of the 1978 Formal Order. The Tenth Circuit put it this way:

> At the trial [of the enforcement action] counsel for Blinder, Robinson did not object to the introduction of evidence obtained through the investigatory order. . . .
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> Even assuming that Blinder, Robinson's attorney's failure to object to the allegedly improper evidence was due solely to the negligence of their counsel rather than to deliberative litigation strategy, this would not constitute a sufficient showing to warrant the extraordinary relief sought.

Id. at 1420.

Those words were penned by our colleagues in the Tenth Circuit almost four years ago. In view of the passage of time, the attack before us is even more tenuous. Stubbornly, Blinder, Robinson maintains (1) that the disciplinary order under challenge in this case is rooted in the decision of the district court in Colorado, and (2) that the latter decision is illegitimately grounded in Fourth Amendment violations. But the foundation of the argument obviously rests on sand, for the Tenth Circuit has, as we have seen, upheld the district court's injunctive order and ruled that Blinder, Robinson can no longer litigate the question of the legality *vel non* of the evidence (or the lawfulness of the 1978 Formal Order itself). We scarcely need remind counsel that this issue litigated fully in the Rockies cannot now be raised on the Eastern Seaboard, and indeed that it was utterly inappropriate even to suggest as much.

B

1. *Issue Preclusion*

In addition to the previously discussed constitutional claims, petitioners contend that the Commission erred in upholding the ALJ's exclusion of evidence proffered by the broker-dealer with respect to the firm's reliance (through Meyer Blinder) on counsel. Specifically, as we alluded to in the factual narrative above, Blinder, Robinson sought in the administrative proceeding to adduce the following evidence before the ALJ: (1) testimony of Meyer Blinder concerning the advice given to him by counsel; (2) testimony from one of the principal attorneys concerning the advice given to Mr. Blinder; and (3) when those requests were denied, the introduction of all evidence concerning reliance on counsel that had been before the district court in the Colorado injunctive proceeding.

The requests were denied by the ALJ on grounds of issue preclusion, inasmuch as the issue concerning good faith reliance on counsel had been litigated in the federal district court and resolved adversely to petitioners. The SEC agreed with the ALJ's determination in this respect, stating that "[t]o allow the introduction of such evidence would permit the very relitigation that the doctrine of collateral estoppel is designed to prevent." J.A. at 541.

The SEC is wrong. The issue before the district court in Colorado was manifestly not the question before the SEC in the administrative proceeding. As is readily apparent, the SEC litigated in federal court the question of petitioners' *liability vel non* under the securities laws. Armed with the findings of fact (and the entry of broad injunctive relief) of the district court, the SEC then instituted an entirely different sort of proceeding, namely an administrative proceeding under section 15(b) of the 1934 Act. That proceeding was aimed at reaching a completely different determination than resolving the issue of liability, including the question of "good-faith reliance"

on counsel. The precise question in the SEC proceeding was whether sanctions should be imposed "in the public interest." Blinder, Robinson makes the argument well:

> This "public interest" determination is separate from and in addition to the SEC's determination as to the existence of the disqualifying conditions necessary for the imposition of any sanctions. As to sanctions, the *extent* to which petitioners sought the advice of counsel, the *clarity* of the advice, and petitioners' reasons for following or disregarding it, in whole or in part, are highly relevant, *even though the reliance on counsel may not have been sufficient to discharge petitioners from the underlying liability for statutory violations.*

Blinder, Robinson Brief at 39-40 (footnote omitted) (emphasis added).

It is important in this respect to draw a clear distinction between the issue before the district court in Colorado—whether Meyer Blinder relied on counsel so as to establish a good-faith defense to liability—and the obviously related, but nonetheless analytically distinct, matter of the circumstances surrounding the lawyer-client relationship. We are in no way suggesting that Meyer Blinder (and, through him, Blinder, Robinson) is at liberty to relitigate the factual question as to whether there was reliance on counsel. That issue has been conclusively decided against him. As the district court expressly found, counsel advised Mr. Blinder to sticker the prospectus, and he chose to reject that advice.

But saying that, and nothing more, is not to state the whole of what is germane to the SEC in exercising its judgment as to the nature and scope of sanctions that are appropriate in the public interest. Unless the SEC is to adopt a sanctioning regime whereby specific offenses call for certain specific sanctions, it seems inescapable that evidence relevant to a party's *degree* of culpability must be considered in deciding that issue. After all, that was

the precise issue in the SEC's section 15(b)(4) proceeding: how culpable was Mr. Blinder? In the district court, the issue was quite different. The finding that Mr. Blinder did not rely on counsel's advice does not tell us about the circumstances surrounding the advice given and Meyer Blinder's rejection of it. Indeed, the district court's opinion did not even address the question in great detail.

In the SEC's administrative proceeding, however, questions of degree were singularly relevant. Mr. Blinder's proffer of evidence in that proceeding was not, and could not have been, directed to litigating the issue of reliance on counsel as relevant to establishing a good-faith defense; rather, it related to the wholly different matter of the entirety of the relationship with counsel (including, for example, why the advice was rejected; which attorney's advice was rejected; the precise nature of the various advice given, *e.g.*, was it absolute and unequivocal, or somewhat flexible in nature, or something else).[10] These latter points go to the question of possible mitigation,

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[10] That is to say, counsel might, hypothetically, provide the following sort of advice: "Course 'x' is beyond question permissible under the securities laws and applicable regulations; no other course is 100 percent clearly permitted. To be completely safe, you should follow Course 'x.'" On the other hand, counsel might advise as follows: "It's not overpowering, but a straight-faced argument can be made that Course 'z' is permissible under the securities laws and applicable regulations. I can't imagine that anyone would go to jail for it, but it's likely to be dicey. You're on much surer and safer ground with Course 'x.' I therefore strongly recommend Course 'x.' Why take chances?"

The foregoing are, of course, only two variations on the same theme. In both hypotheticals, counsel advised in favor of Course x, but each hypothetical carries with it its own peculiar set of nuances. Other themes, and manifold variations on each, are readily conceivable. These matters, it seems to us, can only be adequately appreciated and addressed by the expert agency if it has the full set of facts before it.

notwithstanding the definitively resolved issue of liability and the specific factual determination that Mr. Blinder did not rely on counsel's advice.[11]

Indeed, the strength of petitioners' core argument, that the nature of the administrative proceeding required the SEC to consider evidence relating to Mr. Blinder's degree of culpability, is implicitly conceded by the Commission counsel. As the Commission indicates to us:

> Blinder, Robinson is correct that the district court's judgment is not preclusive as to the issue of what sanctions are required in the public interest.

SEC Brief at 28 n.38 (citation omitted). Yet that is, in effect, precisely what the Commission held. It approved the ALJ's refusal even to consider evidence concerning the relationship(s) with counsel on the theory that to do so would permit relitigation of issues adjudicated in Denver.

That error is not cured, as the SEC lamely suggests, by permitting petitioners to introduce evidence going to other points, such as "their asserted reformation and cessation of deceptive sales techniques." *Id.* The logical

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[11] That possibly mitigating evidence exists is manifest. In determining that counsel's ultimate advice was to sticker the American Leisure prospectus, the district court stated, "[w]hile the evidence is conflicting, the more probable and credible testimony is" that counsel advised against the course of action ultimately chosen by petitioners. *See* 542 F. Supp. at 472. Even conceding that this establishes that Mr. Blinder was not presented with *conflicting* advice as to the proper course of conduct, it tells us nothing about the nature of the advice he did receive, and the circumstances surrounding its rejection. These are matters relating to possible mitigation, which cannot be foreclosed solely because the district court found that Mr. Blinder rejected counsel's advice. Mr. Blinder's conduct, his attitude, indeed, all of the relevant circumstances present in the rejection of counsel's advice, bear on the degree of sanctions that the SEC, as the expert agency, would reasonably deem to be in the public interest.

fallacy of the SEC's argument is apparent. Admitting evidence on issues a, b and c obviously does not cure a tribunal's refusal to consider evidence on issue d, unless of course issue d is irrelevant to the question to be resolved. But in this instance that cannot be. The "public interest" standard is obviously very broad, requiring that the Commission consider the full range of factors bearing on the *judgment* about sanctions that the expert agency ultimately must render. In reaching that judgment, questions such as the precise nature and details of counsel's advice, and indeed, the totality of the circumstances surrounding the lawyer-client relationships in question, are undoubtedly relevant. Blinder, Robinson captures the point admirably:

> Precluding petitioners in administrative disciplinary proceedings from presenting all evidence relevant to the issue of sanctions—whether or not previously presented to a District Court—would do violence to the considered allocations of adjudicatory responsibilities. . . . The statutory obligation placed on the SEC to exercise *its* judgment is not satisfied simply by having the SEC adopt the findings of the District Court.

Blinder, Robinson Brief at 43-44.

We agree. To uphold the SEC's decision here would not only blink at its fundamental error in the treatment of petitioners' attempt to introduce evidence relating to the relationship with counsel, but would also do violence to Congress' intent that the SEC exercise its own judgment in these circumstances. In short, the SEC cannot turn a deaf ear to evidence that should, in reason, bear upon the judgment that the Commission is called upon to render.[12]

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[12] Our holding in this respect should by no means be interpreted as forcing the SEC to engage in an open-ended inquiry without metes and bounds. It has not been argued to us, and we fail to see how it reasonably could be, that the

2. *APA Challenge*

Both petitioners devote considerable energy to attacking the sanctions imposed by the SEC as arbitrarily severe. We have been provided with the following arguments in particular: (1) the SEC subjects over-the-counter firms to disproportionately unfavorable treatment in comparison to Big Board-member firms that similarly run afoul of statutory or regulatory rules and requirements; (2) the SEC, in violation of fundamental requirements of administrative law, failed sufficiently to justify the harsh sanctions visited on petitioners; and (3) the two-year suspension of the firm from all underwriting and private placement activities exceeds the maximum period of suspension authorized under section 15(b)(4) of the 1934 Act. Impressive decisional authority is summoned to buttress the first two points, including an opinion by the late Judge Friendly in *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978), where the Second Circuit set forth a variety of factors to employ in evaluating sanctions imposed by the SEC, and an opinion by our colleagues in the Fifth Circuit in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), *aff'd* 450 U.S. 91 (1981), where the court erected a daunting standard to justify permanent exclusion from the securities industry. ("[P]ermanent exclusion from the industry is 'without justification in fact' unless the Commission specifically articulates compelling reasons for such a sanction." *Id.* at 1140 (footnote omitted)).

The SEC invokes, in response, similarly impressive authority supporting the unquestioned proposition that the crafting of an appropriate remedy is peculiarly with-

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matter of Blinder, Robinson's relationship with counsel was irrelevant to the choice of sanctions imposed under the securities laws. Be that as it may, nothing that we say should be taken to cabin the broad discretion that agencies such as the SEC enjoy in determining what evidence is germane to the determination of the "public interest."

in the province of an expert agency, and can appropriately be judicially disturbed only where the remedy is "unwarranted in law or . . . without justification in fact . . . ." SEC Brief at 11, *quoting Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 185-86 (1973). Commission counsel points to the detailed reasons articulated by the SEC in visiting such substantial sanctions on petitioners. The SEC summarizes its position this way:

> Given the district court's findings that petitioners engaged in an on-going series of deliberately fraudulent transactions that included a deceptive sales campaign, arranging non bona fide transactions to give the appearance that the [American Leisure] offering was sold out, misleading their own counsel and then ignoring counsel's advice, violating the escrow agreement, failing to return investors' money as required, and engaging in prohibited trading in the putative aftermarket, this conclusion [as to sanctions] should need no further explanation.

SEC Brief at 12.

In the course of recounting petitioners' manifold sins, Commission counsel suggests that the factors on which the *Lipper* court relied are not present here. Among those are the following:

> Unlike Mr. Lipper, petitioners [in this case] did not seek counsel's advice as to the totality of the conduct held to violate the securities laws; and, on the only issue that they did seek advice, their purchase of [American Leisure] securities, they rejected the advice they received.

Id. at 14 (citation omitted). By their own words, then, Commission counsel have indicated the relevance of petitioners' relationship with counsel. Petitioners have been weighed in the balance and found wanting, in part because of their disdain for (or failure to secure) counsel's advice. That failure, as the Commission sees it,

plainly related to the conclusion that the American Leisure offering was "permeated with deliberate fraud." *Id.* at 12 (quoting J.A. at 546). But the obvious problem with the SEC's conclusions relating to Mr. Blinder's relationship with counsel is that they assume the Commission had before it the full record germane to determining whether factors such as those emphasized by the *Lipper* court were present. That assumption, for reasons already stated, is ill-founded by virtue of the refusal even to consider potentially relevant evidence.

In brief, we are persuaded that the fundamental principle of administrative law that an agency act in a non-arbitrary, non-capricious fashion is necessarily implicated by the SEC's refusal to permit evidence with respect to a salient factor. That is, in meting out sanctions, the Commission cannot adequately weigh the factors that it concedes should be considered without having before it the full set of facts necessary for reasoned consideration.

Thus, our analysis in this section of the opinion is inevitably affected by the Commission's error, discussed in the preceding section, in refusing to consider evidence relating to the relationship with counsel on grounds of issue preclusion. We will therefore not extend further the length of this opinion, which is obviously but another (albeit important) chapter in this long-lived litigation. Instead, we will put down our pen and remand the case to the Commission for further action consistent with this opinion. On remand, the SEC will, of course, be obliged to satisfy the strictures of the APA by articulating an adequate rationale for whatever decision it may reach.

In this regard, we would be less than candid if we did not flag for the Commission our concern that petitioners have mounted a non-frivolous claim that they have been singled out for disproportionately harsh treatment. Petitioners list a series of instances which, they contend, demonstrate that the SEC's hand comes down more

heavily on smaller, newer firms than it does on old-line, or at least more established, houses with the "right sort" of exchange memberships. The allegation is thus not simply that penalties have differed from case to case. As the colloquies at oral argument suggested, each case in securities regulation, as elsewhere, is different. Those inevitable differences and gradations in fact can best be discerned and articulated by the Commissioners whose job it is to come to just these sorts of judgments.

But it does not exceed our appropriate function to indicate that we have seen warning signs. What is alleged here are not mere disparities, *see Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973), but rather an asserted *systemic pattern of disparate treatment*, resulting in predictably, disproportionately harsh sanctions being visited upon firms such as Blinder, Robinson. If the Commission believes that the alarms are false, then it should say so and explain why what might appear to be troubling systemic variances are in fact not such variances at all, or, alternatively, variances justified by the circumstances of this case.[13] Finally, we emphasize in this respect that the Commission's broad

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[13] For example, at oral argument, counsel for the Commission chose not to rely merely upon salutary principles of broad agency discretion. To the contrary, counsel stated that in typical cases involving larger, more established firms, such firms ordinarily took prompt, remedial action so as to remove offending officials or employees from the firm. That sort of admirable internal housecleaning, counsel suggested, is a far cry from this case, where, as we previously indicated, various key officials, not the least of whom is Mr. Blinder himself, continue to be involved in the operation of the firm.

Needless to say, we do not pass judgment on this contention, or other possible explanations for the sanction imposed here. It is obviously too late in the day to accept the *post hoc* explanations of counsel, especially where, as here, the Commission was content to rely on mere boilerplate as to the undoubted breadth of its discretion. *See* Opinion of the Commission at 16 n.36, J.A. at 551.

discretion in fashioning sanctions in the public interest cannot be strictly cabined according to some mechanical formula. Nothing that we say suggests in the slightest that the Commission does not enjoy wide latitude in fashioning appropriate sanctions; such latitude is inherent in the Commission's broad grant of power from Congress, and is confirmed by such teachings as the Supreme Court's decision in *Butz*.

* * * *

A closing observation is in order: Nothing that we have said today should suggest any intent on our part to intrude into the domain of the previous litigation between these parties in the Tenth Circuit. Petitioners stand condemned for serious violations of the securities laws, and we have held today that it is entirely appropriate and lawful for the SEC to carry out its statutory responsibilities in crafting a suitable and appropriate sanction in response to those violations.

But the Commission must do more than say, in effect, petitioners are bad and must be punished. Petitioners do not stand alone; they are, alas, only two in a long line of enterprises and individuals who have seen fit to conduct themselves in violation of the law of the land. It is because of the SEC's experience in dealing with such unhappy matters that it has the sensitive function, ordained by Congress, of deciding petitioners' fate. In this setting, the Commission is not simply rendering a policy judgment; nor is it simply regulating the securities markets; it is, rather, singling out and directly affecting the livelihood of one commercial enterprise and terminating (possibly forever) the professional career of the firm's founder. Faced with a task of such gravity, the Commission must craft with care.[14]

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[14] It will be apparent to the discerning reader that we have not treated heretofore Blinder, Robinson's contention that the SEC ran afoul of the specific terms of section 15(b)(4) of

III

For the foregoing reasons, the order of the Commission is vacated and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

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the 1934 Act, 15 U.S.C. § 78*o*(b)(4), in imposing on Blinder, Robinson a suspension for a period of longer than one year.

The point need not long detain us. Section 15(b)(4) of the Securities Exchange Act, 15 U.S.C. § 78*o*(b)(4), authorizes the SEC to "censure, place limitations on the activities, functions or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer." Blinder, Robinson argues that it is "clear . . . on the face of the statute" that this list of sanctions is in "ascending order of severity," Brief for Blinder, Robinson at 21 & n.50, so that no "limitations" placed on a broker-dealer's activities may exceed twelve months. In support of a one-year maximum, Blinder, Robinson urges that the order of sanctions was changed in a late draft of the 1934 Act, moving the "place limitations" sanction up from the end of the list to its current position. *Id.*

We disagree. The statute itself indicates that Congress full well knows how to express a time restriction: the Commission, when it suspends the registration of a broker-dealer, may not do so for a "period exceeding twelve months." An analogous section of the 1934 Act, 15 U.S.C. § 78*s*(h)(1), which provides for disciplinary action against industry self-regulatory organizations, contains virtually the same sanctions as section 15(b)(4) in different order: twelve-month suspension, revocation, censure, imposition of limitations. We also observe that the SEC has consistently interpreted section 15(b)(4) to allow limitations of more than one year's duration. *See, e.g.*, Bruce Zimmerman, 46 S.E.C. 509, 513 (1976) (reversing imposition of indefinite limitations on nonstatutory grounds); Joseph H. Gasperini, 32 S.E.C. Dkt. 1842, 1844-45 (1985) (indefinite limitations).

GINSBURG, Ruth B., *concurring*: I join most of the court's fine opinion, but write separately to express some misgivings about the last step my colleagues take. I question the propriety of any remand, particularly one missing well-defined "metes and bounds." *See* court's opinion at 24 n.12.

The distinction my colleagues draw between "reliance on counsel" and "relationship with counsel," *see* court's opinion at 22, slips from my grasp. True, different *claims* were at stake in the Colorado district court and before the SEC, so no claim preclusion operates here. I agree too that a degree of reliance sufficient to count as a mitigating factor in an administrative sanctions determination may be insufficient to constitute a good-faith defense in an injunction proceeding.[1] But degree of reliance never enters into the calculus when there was no reliance at all. Every counsel consulted, the Colorado district court found as a matter of fact, advised against the course of action ultimately chosen by petitioners. *See* court's opinion at 23 n.11, citing the Colorado district court's fact finding reported in 542 F.Supp. at 472.[2] As

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[1] This is the sole force of the SEC's remark quoted in the court's opinion:

> Blinder, Robinson is correct that the district court's judgment is not preclusive as to the issue of what sanctions are required in the public interest.

Court's opinion at 23, quoting SEC Brief at 28 n.38.

[2] The Colorado district court specifically found as fact, after evaluating conflicting evidence, that each counsel had advised Blinder, Robinson it was required by law to sticker the American Leisure prospectus so as to inform investors Blinder, Robinson was itself purchasing the securities it was underwriting. *See* 542 F.Supp. at 472. My colleagues' hypotheticals therefore strike me as inapposite. *See* court's opinion at 22 n.10. This was not an instance of counsel advising a client that certain conduct was permissible but dicey; it was a situation in which counsel advised Blinder, Robinson that stickering was *required, i.e.*, that not stickering the

the Colorado district court reiterated, petitioners directly received "the advice of the involved attorneys," and then, with "knowledge of the materiality of their conduct, and its potential consequences, they ignored counsel's advice." 542 F.Supp. at 476-77. *See also id.* at 481.

If Meyer Blinder is not at liberty to urge again that he relied at all on the advice of counsel, then it is difficult for me to comprehend how a "relationship with counsel" can aid his cause. *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978), is indeed "[i]mpressive decisional authority," *see* court's opinion at 25, but that case seems to me critically different from the one at hand. Judge Friendly held in *Arthur Lipper* that when securities law violators "act under the supervision of experienced . . . counsel," 574 F.2d at 184, SEC sanctions should be mitigated. One who received and "specifically declined to follow" advice of counsel, however, as the Colorado court found Blinder did, 542 F.Supp. at 481, is not largely assisted by precedent sympathetic to a party who acted on counsel's advice. Seeking and then rejecting advice logically should aggravate, not mitigate, blameworthiness.

I note, further, that my colleagues appear to have entrusted to the Commission a comparative analysis obligation heavier than any that has gone before. *See Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases").

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prospectus was *im*permissible. Blinder, Robinson did not reject advice that stickering was the better course of conduct; it rejected advice that stickering was the only permissible course of conduct. In that respect, the "precise nature of [each counsel's] advice," court's opinion at 24, has already been litigated and determined; issue preclusive effect is therefore warranted.

In sum, before returning a case to an agency, I believe a reviewing court has an obligation to specify with great care and precision the "metes and bounds" for the remand. My colleagues say they do not mean to "forc[e] the SEC to engage in an open-ended inquiry." Court's opinion at 24 n.12. I am uneasy, however, about the less than tight instructions the court's opinion contains concerning 1) the limitations now placed on what petitioners and their able counsel may open up or delve into on remand, and 2) what the Commission must do to justify its sanctions. I fear the court's opinion may be read by petitioners to present not limitations as intended, but an opening to introduce anything and everything arguably "relating to the[ir] relationship with counsel." *See* court's opinion at 24.

There is in the remand course ordered some risk of confusion,[3] and an opportunity to protract. I take it to be the view of all members of the panel that the Commission, while instructed to "craft with care," court's opinion at 29, is also to be vigilant to guard against undue protraction and deferral of the final disposition of this case.

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[3] It should be recalled that petitioners' "fruitless efforts" before the ALJ were, according to petitioners' own description, to introduce evidence concerning Meyer Blinder's "reliance on counsel." *See* court's opinion at 5 (quoting from Brief for Petitioner Blinder, Robinson & Co. at 7-8). I therefore underscore the court's definitive ruling that the issue whether there was reliance on counsel "has been conclusively decided against [Meyer Blinder]." *See* court's opinion at 21.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 87-1080 **September Term, 1988**

Blinder, Robinson & Co., Inc.
Petitioner

v.

Securities & Exchange Commission
Respondent

And Consolidated Case No. 87-1086

BEFORE: Ruth B. Ginsburg and Starr, Circuit Judges, and Gesell, U.S. District Judge for the District of Columbia

ORDER

Upon consideration of the Petition for Rehearing of Meyer Blinder, and of the joinder therein of Blinder, Robinson and Company, it is

ORDERED, by the Court, that the Petition is denied.

Per Curiam

United States Court of Appeals
For the District of Columbia Circuit
FILED MAR 17 1988
CONSTANCE L. DUPRE
Clerk

Constance L. DuPre
Clerk

By /s/ Robert I. Bonner
Deputy Clerk,

APPENDIX C

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 23913 / December 19, 1986

Admin. Proc. File No. 3-6380

In the Matter of

BLINDER, ROBINSON & CO., INC.
6455 South Yosemite Street
Englewood, Colorado
(8-15727)

MEYER BLINDER

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Action

Fraudulent Closing of Securities Offering
Fraudulent Representations
Bids For and Purchases of Securities During Distribution
Injunction

Where registered broker-dealer, which was the underwriter of an "all or none" offering, and the firm's president, fraudulently arranged for and made improper purchases of the securities being offered to make it appear that the offering had been successfully completed; made fraudulent

representations to customers in order to sell the securities; bid for and purchased shares of the security before its distribution was completed; and, as a result of the above misconduct, were permanently enjoined from violating antifraud provisions of the federal securities laws; *held,* in the public interest to suspend the firm's registration for 45 days, to prohibit it, for two years thereafter, from participating in any securities offering, and to bar president from association with any broker or dealer with the proviso that, after two years, he may apply to become so associated.

APPEARANCES:

Arthur F. Matthews, Andrew B. Weissman, and *Richard T. Goodstein,* of Wilmer, Cutler & Pickering, for Blinder Robinson & Co., Inc. and Meyer Blinder.

Robert H. Davenport, Rodney K. Vincent, Thomas J. Amy, and *Donald M. Hoerl,* for the Commission's Division of Enforcement.

I.

Blinder, Robinson & Co., Inc. ("registrant"), a registered broker-dealer, and Meyer Blinder, registrant's president, appeal from the decision of an administrative law judge. The law judge found that respondents had violated antifraud provisions and been enjoined from further violations of those provisions in an action brought by this Commission. He concluded that the firm's broker-dealer registration should be suspended for 45 days, that Blinder should be suspended from association with any broker or dealer for 90 days and that, for two years following registrant's suspension, respondents should be prohibited from participating in any securities offering.[1] The Divi-

[1]The law judge specified that, during its suspension, registrant could effect unsolicited retail transactions and inter-dealer transactions related thereto; complete outstanding transactions; and deliver and transfer securities.

sion of Enforcement also appeals, seeking an increase in the sanctions imposed on Blinder. Our findings are based on an independent review of the record except for findings of fact that are not challenged on review.

II.

Registrant is a nationwide securities firm specializing in "penny" stocks. The firm makes a market in about 70 issues, the great majority of which are securities that it has underwritten. At the time of the hearing, Blinder owned about two thirds of registrant's stock.

The charges in this proceeding are the same as the charges in the above injunctive action against respondents. In that action, a federal district court found, after trial, that respondents had engaged in serious and extensive violations of the antifraud provisions of the federal securities laws[2] in connection with registrant's underwriting of the securities of American Leisure Corporation ("Leisure"). Respondents were permanently enjoined from further violations of those provisions.[3] The Court of Appeals affirmed the District Court's findings and order[4], and the Supreme Court denied certiorari.[5] The law judge adopted the court's findings.

The District Court found that the firm and Blinder used fraudulent sales practices to sell the Leisure offering, falsely made it appear that the offering's "all or none" condition had

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[2]Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(2) of the Securities Exchange Act, and Rules 10b-5, 10b-6, 10b-9 and 15c2-4 under the Exchange Act.

[3]*SEC v. Blinder, Robinson & Co., Inc.*, 542 F. Supp. 468 (D. Colo. 1982).

[4]*SEC v. Blinder, Robinson & Co.*, [1983 - 1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶99,491 (10th Cir. 1983)

[5]469 U.S. 1108 (1985).

been met with the result that investors' funds were not returned as required by the terms of the Leisure prospectus, and made unlawful bids and purchases during the Leisure distribution that continued after the purported close of the offering.

III.

The findings of the District Court are summarized in this section.

In 1979, Leisure, a company with no operating history, hoped to build and operate an Atlantic City hotel-casino. However, the company had only 1.72 acres of unimproved land — not enough for its contemplated development.[6] Another company, Cavanagh Communities Corp. ("CCC"), had a contract to buy, and later acquired, 8.4 acres of land near the site owned by Leisure. CCC initially expressed interest in making a deal with Leisure if financing for Leisure's project could be obtained through an underwriting by registrant. However, Leisure's talks with CCC were broken off in January 1980 because CCC was negotiating with another company.

In 1979, registrant agreed to act as "best efforts" underwriter for an "all or none" offering of 10 million shares of Leisure common stock plus warrants at a unit price of $2.50. The offering period was to run from December 26, 1979 to March 25, 1980, and the offering proceeds were to be held in escrow at the Metro Bank of Denver. Under the terms of the offering, all of the Leisure units had to be sold within the prescribed period or subscribers' funds would be refunded in full.

Sales of Leisure units opened briskly, fueled by a deliberately deceptive sales campaign orchestrated by Blinder. Blinder

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[6]Leisure needed either additional land or the grant of certain variances to use the parcel it owned.

knew that there had been no positive developments in Leisure's prospects. Nevertheless, at a January 1980 sales managers' meeting, he stated that negotiations for the additional land that Leisure needed were proceeding, that Leisure's hotel-casino development was assured because of deals being made, and that a public announcement would be forthcoming. The firm's sales force relayed these statements to customers. The salesmen also made baseless predictions of an aftermarket premium, sometimes quoting a price of $5 or higher, and suggested that registrant had favorable inside information concerning Leisure.

Despite registrant's aggressive and fraudulent sales promotion, its sales campaign lost momentum. At that point, another broker-dealer, Elkins and Co., agreed to a $2.5 million participation in the offering in order to supplement registrant's efforts. However, Elkins deemed it advisable to draft a letter informing investors that there was no agreement between Leisure and CCC, and that negotiations had been terminated. On March 5, 1980, an Elkins official read the draft letter to C. James Padgett, then registrant's vice president. Padgett rejected the letter, urging that it not be sent since he still hoped for an agreement with CCC. As a result, Elkins withdrew from the underwriting and sent the letter to its customers, many of whom cancelled the Leisure purchases they had already made.

As the March 25 deadline drew nearer, it became apparent that not all of the Leisure offering could be sold to the public. By March 20, counsel had advised both Blinder and Padgett that, if registrant wished to purchase a large block of the unsold units, it would have to supplement the prospectus with a "sticker" disclosing its purchase. Registrant and Blinder rejected this advice. They felt that the firm's reputation would suffer if its failure to sell the offering were publicized. Accor-

dingly, they resorted to frantic maneuvers in an effort to dispose of the remaining 20% of the offering. These included the following three non-bona fide sales.

1. On March 21, Leisure entered into an arrangement with another company, Scope, Inc., and a Florida bank. Leisure agreed to buy two $1.5 million certificates of deposit from the bank — one at the market rate of 16% interest, and the other at 10%. The bank loaned Scope $1.5 million at 12% interest to buy 600,000 units of the Leisure offering.

2. On the same day, a salesman of the firm arranged for one of his customers to obtain a $700,000 loan from the Metro bank in order to purchase 400,000 units of Leisure. The customer had no prior connection with Metro, which loaned the money in order to assist registrant, a good customer of the bank.

3. On March 24, registrant bought the remaining 956,393 units of Leisure with a $2,371,987.50 Metro loan. Contrary to normal practice, the bank's loan records did not reflect this transaction.

On March 25, the Leisure offering was closed. Metro credited registrant with $2,475,000, representing its commission for selling 10 million units of Leisure. The credit was used to repay the loan that Metro had made to registrant on the previous day, making it clear that the loan was simply a premature commission payment. On the same day, Metro wired $3 million from the escrow account to the Florida bank so that Leisure could buy the necessary certificates of deposit under its arrangement with Scope.

After the purported close of the offering, the firm's distribution of the 956,393 units of Leisure that it had purchased for

its own account continued, and it began trading the securities in the aftermarket. From March 25 until July 18, 1980, while selling 2,209,320 units of Leisure, the firm entered bids for and purchased 1,829,715 units.

Respondents acted with scienter, with the deliberate intention of deceiving investors. Blinder directed a fraudulent sales campaign that produced quick sales in the offering's early stages. The offering's subsequent termination was, as Blinder knew, a mere pretense. Blinder either directed, or at least was aware of, the firm's purchase of a large block of the offering. The fraudulent actions of parties outside the firm, like Metro, were simply components of respondents' deceptive scheme that was designed to make it appear that the offering had been successfully completed. Respondents either directed those activities or, with full knowledge, tacitly approved them. Although the requisite amount of bona fide sales had not been made by the specified deadline, respondents did not return investors' funds. Instead, at respondents' instructions, the escrowed monies were disbursed to pay the firm its underwriting commission, to pay the Florida bank for the certificates of deposit Leisure had purchased under its arrangement with Scope, and to pay the remaining proceeds of the offering to Lesiure. Thereafter, respondents bid for and purchased Leisure securities while continuing their distribution of those securities after the purported close of the offering.

Blinder's intent to deceive defeats respondents' claim of good faith reliance on the advice of counsel. In fact, respondents spurned counsel's advice. Moreover, Blinder did not make full disclosure to counsel of all the pertinent facts.

By their deceptive sales campaign and fraudulent closing of the Leisure offering, respondents violated the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, and Rule 10b-5 thereunder.

Respondents also violated Rule 10b-9 under the Exchange Act[7] since their failure to return investors' funds made false their representation that the offering was being made on an "all or none" basis. Moreover, respondents' failure to return investors' funds and their disbursement of such funds from escrow violated Rule 15c2-4 under that Act.[8] Finally, respondents' bids for, and purchases of, Leisure securities during the continuing distribution of Leisure after the purported close of the offering violated Rule 10b-6 under the Exchange Act.[9]

IV.

As noted above, the charges that the court sustained in the injunctive action are the same as the charges against respondents in this administrative proceeding. Thus it seems clear that, under the doctrine of collateral estoppel, the court's findings are binding on respondents here. The willfulness requirement in these proceedings is satisfied by the court's conclusion that respondents acted with scienter. As the Supreme Court has explained:

> "Collateral estoppel, like the related doctrine of res judicata, has the dual purpose of protecting litigants

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[7]Rule 10b-9 prohibits representations that a security is being offered on an "all or none" basis unless the offering is made on condition that the consideration paid will be refunded to the purchasers unless all of the securities are sold at the specified price within the specified time.

[8]Rule 15c2-4 makes it a fraudulent practice for a broker-dealer participating in an "all or none" distribution to withdraw investors' funds from escrow until the stated event or contingency has occurred, at which time the funds must be prompty transmitted or returned to the persons entitled thereto.

[9]Rule 10b-6 provides that it is a manipulative or deceptive device for an underwriter participating in a distribution of securities to bid for or purchase such securities until the underwriter has completed its participation in the distribution.

> from the burden of relitigating an identical issue with the same party . . . and of preventing needless litigation. * * * Under the doctrine of collateral estoppel, . . . the second action is [based] upon a different cause of action and the judgment in the prior suit precludes relitigation of issues actually litigated and necessary to the outcome of the first action.''[10]

We accordingly find, on the basis of the court's findings set forth above, that respondents willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5, 10b-6, and 10b-9 thereunder. We also find that registrant, willfully aided and abetted by Blinder, willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

Respondents contend that the law judge erred in excluding evidence of their asserted reliance on the advice of counsel, a defense that the court expressly rejected. We do not agree. Nor do we agree that such evidence was necessary to put the injunction ''in perspective.'' To allow the introduction of such evidence would permit the very relitigation that the doctrine of collateral estoppel is designed to prevent.

Respondents further argue that applying collateral estoppel is unfair since the representation afforded them by their counsel in the injunctive action was inadequate. However, respondents have already litigated the issue of their former counsel's competence in an action seeking to vacate the injunction entered against them.[11] In affirming the District

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[10]*Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 326 and n.5 (1979).

[11]Respondents also contended in their court papers, as they do here, that their former counsel had a possible conflict of interest since he may have been negotiating with some of registrant's personnel to form a competing brokerage firm. They also pointed to the potential use of the court's injunctive findings in an administrative proceeding brought by this Com-

Court's denial of respondents' motion to vacate, the Court of Appeals stated:

> "We agree with the district court that Blinder, Robinson was represented in the [injunctive action] by competent and experienced lawyers who made a tactical decision which binds their clients."[12]

Thus no inequity exists. Under the circumstances, we find no unfairness in the application of collateral estoppel, and no reason to permit respondents to relitigate in these proceedings the issue of the representation accorded them by their former counsel. We accordingly affirm the law judge's determination to exclude evidence relating to that issue.[13]

Respondents further argue that, for purposes of applying collateral estoppel, it is improper to rely on the District Court's determinations except for the "narrowest findings necessary to support the court's judgment." We do not agree. We view every significant finding of the court as necessary to its conclusion and appropriate for adoption herein. Such findings, which are summarized above, are not limited to the court's narrow determinations of what specific statutory provisions and rules were violated, but include all findings that reveal the

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mission. Respondents' motion and briefs to the courts on the issue of their former counsel's representation are hereby admitted into evidence.

[12]*Blinder, Robinson & Co., Inc. v. SEC*, 748 F.2d 1415, 1421 (10th Cir. 1984), *cert. denied*, 105 S.Ct. 2655 (1985).

[13]Respondents also challenge the fairness of applying collateral estoppel on the ground that the evidence against them in the injunctive action was allegedly tainted because it was assertedly obtained in an unlawful investigation. However, respondents have not shown that the conduct of the investigation had any bearing on the fairness of the manner in which the issues were tried in that action, or on the reliability of the determinations that were made therein. Moreover, as more fully discussed elsewhere in this opinion, we find no impropriety with respect to the authorization or conduct of our investigation.

nature and extent of the misconduct in which respondents engaged. Just as such findings are important in determining what sanctions are appropriate here in the public interest, they clearly played an important role in the court's determination to issue an injunction.[14] In affirming that determination, the Court of Appeals cited the District Court's findings "on the several elements or aspects of the case," including "[t]he nature of the violations, the knowledge that certain actions were in violation, placement of the shares purchased in the trading account, the deliberate deception by the sales force," the court's finding that respondents knew that the closing of the offering was "a pretense," and the court's conclusion that respondents "acted with a knowing intent to deceive, manipulate or defraud."[15]

V.

Respondents argue that these proceedings should be dismissed because of alleged misconduct in our investigation of the Leisure offering. In the alternative, they ask us to exclude the District Court's findings and injunction from the record as the fruits of such misconduct. The pertinent facts are as follows.

On August 3, 1978, we issued an investigative order that was triggered by staff reports of fraudulent conduct on the part of registrant in connection with new securities issues of "highly speculative, recently organized issuers." The order authorized our staff to conduct a private investigation to determine whe-

[14]As one authority has stated: "Although it is always possible that the same remedy might have been ordered on the basis of fewer findings, it is better to recognize a principle of remedial necessity that justifies preclusion as to all findings deemed appropriate in justifying the remedy ordered." Wright, Miller & Cooper, *Federal Practice and Procedure* § 4421, p. 198 (1981). *See also Tanker Hygrade No. 18, Inc. v. United States*, 526 F.2d 805 (Ct. Cl. 1975), *cert. denied*, 426 U.S. 920 (1976).

[15]*SEC v. Blinder, Robinson & Co., supra*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) at p. 96,858.

ther registrant or others "[had] engaged or [were] about to engage in any of the reported acts or practices or in any acts or practices of similar purport or object." To that end, the order gave certain named staff members the power to issue subpoenas and take evidence. In 1980, on the basis of that order, our staff investigated respondents' activities in connection with the Leisure offering. As a result, we instituted the above injunctive action against respondents in August 1980.

Respondents contend that both the investigative order and our staff's use of it were overbroad. They complain that the order contained no specific time limit and targeted no specific transactions; that it was unrelated in time or nature to the Leisure offering; and that whatever authority it originally conferred had expired by the time of the Leisure investigation.

We do not agree that our investigative order was overbroad, or that our staff exceeded the legitimate scope of the inquiry that we authorized. Congress has endowed us with broad powers to investigate,[16] and we may exercise those powers not only to determine whether certain firms or individuals have already violated the law but also to investigate their continuing activities in the area under examination.[17] As we have previously pointed out,[18] we do not interpret the terms "about to engage" in our investigative order, "about to be violated" in Section 20(a) of the Securities Act, and "about to violate" in Section 21(a) of the Exchange Act as narrowly as respond-

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[16]*See, e.g., Arthur Young & Company*, 584 F.2d 1018 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 1071 (1979).

[17]*See* Sections 19(b) and 20(a) of the Securities Act, and Section 21(a) of the Exchange Act.

[18]Order of December 4, 1984 in these proceedings, rejecting respondents' interlocutory appeal from the law judge's denial of their motion for discovery relating to the investigation. Contrary to respondents contention, we think that the law judge also properly denied the issuance of subpoenas requested by respondents seeking to explore the same area.

ents would construe those phrases.[19] We had received reports of serious misconduct on the part of registrant with respect to new securities issues of a number of "highly speculative, recently organized issuers." Our order not only authorized a probe of registrant's past activities in that area, but also a continuing surveillance of registrant's dealings in the new securities issues of such companies. Respondents' fraudulent activities with respect to the securites of Leisure fell within the scope of the investigation we had authorized.

Even assuming that there was some defect in our investigative order, or our staff's implementation thereof, the relief respondents seek is unjustified. Any such irregularity would not constitute misconduct of sufficient magnitude to warrant dismissal of these proceedings.[20] Moreover, respondents did not object to the introduction of evidence in the injunctive action because it was assertedly "tainted" by reason of its being obtained in an unlawful investigation. They cannot mount a collateral attack here by seeking to exclude the court's findings and judgment because they were based on that evidence.[21]

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[19]*Cf. SEC v. Culpepper*, 270 F.2d 241, 249-250 (2d Cir. 1959); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 807 (2d Cir. 1975).

[20]*See United States v. Romano*, 706 F.2d 370, 372 (2d Cir. 1983); *United States v. Thibadeau*, 671 F.2d 75, 78 (2d Cir. 1982); *United States v. Graves*, 556 F.2d 1319, 1323 (5th Cir. 1977), *cert. denied*, 435 U.S. 923 (1978); *United States v. Houghton*, 554 F.2d 1219, 1224 (1st Cir.), *cert. denied*, 434 U.S. 851 (1977).

[21]*See, e.g., Gary L. Jackson*, Accounting and Auditing Enforcement Release No. 85 (January 21, 1986), 34 SEC Docket 1947, 1950; *Herbert Rapp*, 41 S.E.C. 854, 857 (1964); *Kimball Securities, Inc.*, 39 S.E.C. 921, 924 n.4 (1960).

Respondents seek to adduce into evidence the voluminous materials they submitted in support of a motion, which we denied, requesting a stay pending the court's disposition of another motion by respondents to vacate the injunction against them. Respondents have not shown, in accordance with Rule 21(d) of our Rules of Practice, that the evidence in question

VI.

Respondents contend that the sanctions assessed by the law judge are too severe. They argue, among other things, that the injunction is a sufficient remedy, that the proposed sanctions would unduly harm the firm and many innocent persons, and that respondents have transformed registrant through extensive reforms. The Division of Enforcement maintains that the sanctions imposed on registrant by the law judge are appropriate but that those assessed against Blinder are too lenient.

We agree with our staff. Accordingly, we shall affirm the sanctions imposed on registrant.[22] However, we have concluded that, at a minimum, the public interest requires that Blinder should be barred from association with any broker or dealer with the proviso that, after two years, he may apply for permission to become so associated.

In assessing sanctions, we have been guided by the factors cited by the court in *Steadman v. SEC*[23], as follows:

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is material and that there were reasonable grounds for failing to adduce it at the hearings before the law judge. Their motion is accordingly denied.

[22]Respondents argue that we may not limit registrant's underwriting activities for more than one year. However, the plain language of Section 15(b)(4) of the Exchange Act does not restrict the duration of the period for which limitations may be imposed on registrant's operations. Nor do respondents' citations of legislative history support their claim that such a restriction was intended by Congress. Respondents further contend that any sanctions against registrant should be limited to its underwriting of contingent offerings. However, registrant engaged in additional misconduct that was unrelated to the contingent nature of the Leisure offering. Moreover, we see no reason why the scope of the sanctions we impose should be limited to the precise activity that gave rise to the misconduct at issue, particularly when fraudulent conduct is involved that may be repeated in other areas.

[23]603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).

> "[T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations."[24]

As set forth below, all of these factors weigh in favor of the determinations we have made.

Respondents' violations could hardly be more serious. The Leisure offering was permeated with deliberate fraud. Over an extended period of time, investors were cheated and deceived – first in the initial sales campaign, then by the fraudulent closing with its accompanying failure to return investors' funds, and finally by the manipulative activity that accompanied the continued Leisure distribution in the putative "aftermarket."

Orchestrating all of this activity was registrant's president and majority shareholder, Meyer Blinder. Blinder launched registrant's fraudulent sales campaign with baseless assurances of Leisure's success. When those proved insufficient to sell out the offering, he determined to close it through other fraudulent devices. Accordingly, undisclosed non-bona fide transactions were arranged to give the appearance that the offering had been successfully completed. Blinder arranged for registrant itself to buy a large block of the offering, using the underwriting commission to which it was not entitled to pay for its purchase. Advised by counsel to disclose that purchase, Blinder refused. His reason for concealment – that the public would learn that registrant was unable to sell the offering – was the very reason that disclosure was required.[25] Thereafter,

[24] *Id.*, 603 F.2d at 1140.

[25] *See A. J. White & Co. v. SEC*, 556 F.2d 619 (1st Cir. 1977).

Blinder began reselling the securities that registrant had purchased – a distribution that was aided by respondents' illegal market activity.

The abuses that marked the Leisure offering were not an isolated instance of misconduct. They were simply the most egregious example in a history that demonstrates respondents' disdain for compliance with regulatory requirements. Indeed, Blinder admitted that his firm routinely ignored compliance with state securities laws. That policy resulted in a host of disciplinary actions. Registrant has been sanctioned in at least 17 proceedings instituted in 16 different states.[26] Moreover, in 1982, we affirmed findings by the National Association of Securities Dealers, Inc. ("NASD") that respondents failed to exercise adequate supervision in connection with their salesmen's violations of the NASD's free-riding interpretation. We found that "there was a total absence of adequate supervisory procedures" which "was particularly serious in light of the numerous public offerings in which the firm was involved."[27]

Respondents claim that they have reformed.[28] They cite a series of changes that have assertedly transformed

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[26]We take official notice of registrant's amendments to its broker-dealer registration application that reflect some of those proceedings.

[27]*Blinder, Robinson & Co., Inc.*, Securities Exchange Act Release No. 19057 (September 17, 1982), 26 SEC Docket 238, 240.

[28]Respondents object to the law judge's admission of evidence introduced by our staff in response to that claim. The evidence involves alleged misstatements by registrant's sales force in selling the stock of Cable West Corporation and respondents' allegedly inadequate investigation of those transactions. Respondents note that the order for proceedings does not charge them with any violations in connection with Cable West. However, the fact that issues have not been raised by the pleadings does not preclude the admission of evidence in rebuttal of a particular defense contention. *See Van Tassel v. Patterson*, 50 N.W. 2d 113, 117 (Minn. 1951); *Campbell v. State*, 501 A.2d 111, 116 (Md. App. 1985); *Hutchinson v. Shaheen*,

registrant into a model brokerage firm. Among these are the hiring of compliance-minded officers, the installation of a computer system designed to help prevent certain improper transactions, and a three-week training program for salesmen.

We are not persuaded by these contentions. Respondents' training program, one of the reforms of which they boast, is used to teach salesmen a highly deceptive sales technique which is apparently a mainstay of registrant's sales production.[29] The technique involves a series of three telephone calls, one week apart, made to prospective customers whose name are culled from telephone books or lists of prospects. In the initial version of this technique, the first call concluded with the salesman stating that he would call again "[a]s soon as something that I think is exciting comes up." In the second call, the salesman explained that "nothing has come up yet" but "our research department is working on something that looks very exciting." Finally, in the third call, the salesman presented the "very exciting" stock.

This presentation was wholly misleading. Prospective customers were led to believe that registrant would recommend a highly promising stock that had been carefully selected on the basis of its research department's expertise. In fact, registrant's "research department" consists of a single individual. That person, who has no training in financial analysis, does not recommend any securities to registrant's salesmen. Instead, he merely acts as a

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390 N.Y.S. 2d 317, 319 (Sup. Ct. 1976). Here the evidence in question was introduced solely to rebut respondents' claims of reform. In any event, we have not relied on that evidence, or on the law judge's findings with respect thereto, in determining what sanctions are appropriate in the public interest. Thus respondents have not been prejudiced.

[29]The scripts used in the program are not necessarily verbatim renditions of salesmen's actual statements. However, they do constitute the substance of what salesmen have been taught to say.

marketing facilitator by furnishing salesmen with information that he receives from companies (or their public relations firms) in whose securities registrant is making a market ("Blinder stocks").[30] The salesman simply picked one of those securities for his third call and enthusiastically recommended it to the prospect as the "very exciting" stock to which he had previously referred. The prospect was then asked if he could handle 100,000 shares or even more.[31]

Respondents were apprised of the questionable nature of their sales technique when the law judge questioned John Cox, registrant's compliance director, about its propriety. They accordingly prepared a revised sales script that the law judge admitted into evidence after the close of the hearings. However, the revised version, while toning down some of the original's language, retains the key elements of registrant's highly deceptive approach. It builds up the prospect's trust, whets his appetite for something exciting that the "research department" will discover, and then purports to satisfy that expectation with the recommendation of a "very exciting" security that in fact is selected from the regular list of Blinder stocks.

Respondents further point to the many personnel changes that they have made subsequent to the Leisure offering. In particular, they note that Padgett, the subject of findings

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[30]As previously noted, the great majority of stocks in which registrant makes a market are securities that it has underwritten.

[31]Theoretically, the salesman could recommend other securities. However, to make such recommendations, other than on an isolated basis, the salesman must obtain the approval of registrant's executive vice president after the compilation of a complete "due diligence" file. One of registrant's branch office managers testified that, because of the information readily available on Blinder stocks, those issues constituted the overwhelming majority of securities sold by his office.

by the District Court concerning his involvement in the Leisure fraud, has been replaced as registrant's second-in-command. They also maintain that Cox, a former NASD compliance expert hired to fill a newly-created post in 1984, has authority to overrule everyone, including Blinder, on compliance matters.

These arguments carry little weight. In 1983, Padgett and other officers of registrant formed a competing brokerage firm, hired away many of registrant's employees, and, in Blinder's words, "stripped" the firm. Blinder admittedly "had to bring in new people." Moreover, three current high-ranking officers of registrant have disciplinary records. In addition, the law judge, who heard the witnesses and observed their demeanor, refused to credit the testimony of Blinder and Cox that Cox rather than Blinder, had "final authority" in compliance matters. We find no basis for disagreement with the law judge's assessment.[32] We further note that Cox did not take adequate steps to terminate the deceptive sales techniques described above.

In sum, we conclude that the compliance-related changes made by respondents did not represent a change in heart, but primarily a reaction to the prospect of an administrative proceeding based on the injunction. Blinder remains in control of registrant, a fact of particular significance in view of his attitude toward applicable regulatory requirements. This fact did not escape the District Court's attention when, on July 11, 1986, it denied yet another mo-

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[32]We note that Cox testified that, even if registrant's computer rejected a particular transaction as improper, "I would say without a shadow of a doubt that Meyer Blinder could override the computer."

tion by respondents to vacate the injunction. The court stated:

> "What troubles me about Mr. Blinder's affidavit is that I am not sure he still understands what happened here. There is a tendency once again to say, well, I made a mistake . . . There is a flavor to it, in my judgment, that says, well I didn't dot the i's and cross the t's and that was a mistake. That isn't the reason for the injunction. There was a disregard not just for the opinions of counsel, but a disregard of the requirements of the law. And Mr. Blinder remains in control of this organization. . . . [I]n terms of looking to whether there is any continuing reason for the injunction, there is. And one of the continuing reasons for the injunction is Mr. Blinder is still in control of this organization and, in my judgment, is not fully aware of his own fault in this case, and [that is] one of the reasons, a principal reason, for the injunction against his firm."[33]

Respondents further contend that the sanctions imposed by the law judge would threaten registrant's business, work hardship on its employees, impair respondents' charitable contributions, and deprive the penny stock industry of registrant's underwriting and marketmaking functions. However, even assuming that the sanctions we are imposing may have some negative impact on various persons who were not involved in respondents' wrongdoing, we cannot allow that factor to control our determinations. Our overriding concern must be to protect public investors against any repetition of the blatant misconduct in which

[33]The transcript of the court's remarks is hereby admitted into evidence.

respondents engaged. The sanctions we are imposing are designed to produce that result[34].

We recognize the serious effect of the sanctions we are imposing. But we are convinced that lesser sanctions will not suffice. Our action is designed to protect the public interest not only by restricting respondents' future activity in the securities business but also by deterring them from any repetition of their violative practices. The sanctions are a clear message to registrant, and to Blinder if and when he returns to the securities business, that any recurrence of misconduct will be dealt with severely. At the same time, the sanctions serve the important purpose of general deterrence, and should operate as a warning to any other participant in the securities industry who might be tempted to engage in similar misconduct.[35] In light of the extremely serious nature of respondents' violative activity, and their prior disciplinary history, lesser sanctions could not be expected to accomplish that purpose.[36]

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[34]We find no merit in respondents' claim that the law judge improperly excluded testimony by the executives of five issuers to the effect that registrant's underwriting activities are essential. Even assuming that this is true in the case of those issuers, it would not alter our conclusion as to the proper sanction to impose on registrant in the public interest.

[35]*See Arthur Lipper Corporation v. SEC*, 547 F.2d 171, 184 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).

[36]Respondents claim that lighter sanctions have been assessed in comparable cases, including some that were imposed pursuant to offers of settlement. However, the remedial action that is appropriate in the public interest depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with the action taken in other cases. *See Butz v. Glover Livestock Commission Co., Inc.*, 411 U.S. 182, 187 (1973); *Hiller v. SEC*, 429 F.2d 856, 858-859 (2d Cir. 1970). Moreover, in settled cases we take into account pragmatic considerations such as the avoidance of time-consuming and manpower-consuming adver-

An appropriate order will issue.[37]

By the Commission (Commissioners COX, PETERS and FLEISCHMAN); Chairman SHAD and Commissioner GRUNDFEST not participating.

/s/

Jonathan G. Katz
Secretary

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sary proceedings. *See, e.g., Haight & Company, Inc.*, 44 S.E.C. 481, 512-513 (1971), *aff'd without opinion* (D.C. Cir., June 30, 1971), *cert. denied* 404 U.S. 1058 (1972); *Owen v. Kane*, Securities Exchange Act Release No. 23827 (November 20, 1986), 37 SEC Docket 35, 41 n.14.

[37]We have considered all of respondents' contentions. Their exceptions to the initial decision are overruled or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 23913 / December 19, 1986

Admin. Proc. File No. 3-6380

In the Matter of
BLINDER, ROBINSON & CO., INC. 6455 South Yosemite Street Englewood, Colorado (8-15727)
MEYER BLINDER

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day it is

ORDERED that the broker-dealer registration of Blinder, Robinson & Co., Inc. ("registrant") be, and it hereby is, suspended for a period of 45 days, commencing at the opening of business on January 12, 1987, *provided, however*, that during such period registrant may nevertheless effect unsolicited retail customer transactions and inter-dealer transactions related thereto, complete outstanding transactions, and make deliveries and transfers of securities; and it is further

ORDERED that, for a period of two years following the suspension referred to above, registrant be, and it hereby is, prohibited from participating, directly or indirectly, in any securities offering as underwriter, selling group member, or in any other manner; and it is further

ORDERED that Meyer Blinder be, and he hereby is, barred from association with any broker or dealer, effective at the opening of business on March 23, 1987, *provided, however,* that, after a period of two years from that date, he may apply to the appropriate self-regulatory organization for permission to become so associated.

By the Commission.

/s/
Jonathan G. Katz
Secretary

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEYER BLINDER	)	
v.	)	Civil Action No. 87-1080
SECURITIES AND EXCHANGE COMMISSION	)	87-1086

City of Washington	)	
	)	ss:
District of Columbia	)	

AFFIDAVIT OF HARVEY L. PITT

Harvey L. Pitt, being duly sworn, deposes and says as follows:

1. I submit this affidavit, at the request of counsel for Defendant Meyer Blinder, in connection with the Defendant's Petition for Rehearing in this proceeding. The facts set forth herein are true and accurate to the best of my personal knowledge and belief.

I. **Qualifications.**

2. Since 1978, I have been a partner in the Washington-New York-Los Angeles-London law firm of Fried, Frank Harris, Shriver & Jacobson ("Fried, Frank").

3. From 1968 until 1978, prior to joining Fried, Frank, I was employed in a variety of capacities by the United States Securities and Exchange Commission ("SEC" or "Commission"). I served as the Commission's General Counsel – the agency's Chief Legal Officer – from 1975 to 1978.

II. Background to Testimony in this Case.

4. On February 10, 1988, Nathan Lewin, a partner in the law firm of Miller, Cassidy, Larroca & Lewin, in his capacity as counsel to Meyer Blinder in this proceeding, asked me if I would prepare an affidavit, setting forth my knowledge, as an expert, regarding the disparities and similarities between SEC civil injunctive actions and SEC administrative proceedings.

5. Previously, I have briefly represented Meyer Blinder for the sole purpose of exploring with Commission staff members the possible consensual disposition of the Commission's administrative proceedings against Mr. Blinder. At no time prior to the execution of this affidavit have I been involved in any aspect of this litigation, nor do I take any position with respect to the outcome of this Petition.

III. Distinctions between the Commission's Role in its Own Civil Litigation and in the Conduct of its Own Administrative Proceedings.

6. I have been asked to give my opinions as to the distinctions between the Commission's functions when it acts as a civil litigant, and when it initiates and conducts administrative proceedings. I believe that several factors bear on this issue.

7. It was my experience at the Commission that the SEC Commissioners, in determining whether to bring a civil action, considered all of the factors that any civil litigant would consider. The Commissioners consider the factual allegations the staff proposes to make, and the Commissioners satisfy themselves that, based on the facts and the relevant law, it is correct and right to bring the action, and that there is a reasonable justification for each of the allegations that the Commission intends to make. The Commissioners analyze the question of whether to bring a civil action based upon a memorandum that is prepared by the staff, and it is not unusual for the Commissioners to review, and change, the specific allegations in a draft complaint.

8. Typically, the staff of the Division of Enforcement investigates a matter, and recommends to the Commissioners the enforcement action that the Division believes should be taken, in an elaborate memorandum which details the factual issues and legal theories involved in the case. This memorandum is circulated to all of the other divisions of the Commission, and to the Commission's General Counsel. The General Counsel reviews any recommended action in his capacity as Chief Legal Officer of the Commission. The directors of the Commission's other divisions also have the opportunity to opine on the policy and legal implications involved in taking the recommended action, and the Commissioners consider these implications in deciding whether to file a civil suit. It is not uncommon, in my experience, for members of the Commission to request, or for the staff on its own initiative to proffer, particularly pertinent evidentiary support for proposed factual allegations. The Commission will take up the Enforcement Division's recommendation at a closed meeting, and may hear extended discussion regarding any and all facets of the pro-

posed injunctive action. I have sat through some meetings where virtually every major evidentiary allegation has been carefully reviewed by the Commissioners and the staff.

9. Administrative proceedings are usually brought against entities regulated by the Commission. Since the Commission has always viewed its administrative proceedings as an appropriate means by which it can craft regulatory policy, the Commissioners may decide to initiate an administrative proceeding in circumstances when the matter involves important policy or ethical questions even though it does not involve a clear cut violation of law. By contrast, when the Commissioners decide to bring a civil injunctive action, they take steps to satisfy themselves that there is a substantial basis upon which to believe that the potential defendant, unless enjoined, will violate the federal securities laws in the future. In virtually every case, this likelihood of future violations is based upon substantial evidence of serious past violations.

10. I believe that there is a distinction between the Commissioners' involvement in an injunctive proceeding, as opposed to their involvement in an administrative proceeding. In a civil injunctive action, the Commissioners are interested parties; as such, they are kept advised of major developments, and there is no restriction on the information about a pending case that may be forwarded to the Commissioners. By contrast, in administrative proceedings, in which the Commissioners act as the tribunal and the judges, there is a strict separation of functions, and the Commissioners are not advised of the staff's activities in connection with the proceedings, except to the extent they receive such information in their capacity as judges. Indeed, on one occasion, I recall that Mr. Phillip A. Loomis, then a Commissioner of the SEC, presented argu-

ment for the Commission in one facet of its civil injunctive action against Robert Vesco, in New York. In contrast, to my knowledge, a Commissioner never would, and no Commissioner ever has, presented argument in an administrative proceeding he or she authorized as a member of the Commission.

11. A major distinction between a civil action and an administrative action, is that the Commissioners may communicate more freely with the staff with regard to the ongoing action and influence the course and direction of the proceedings.

12. It was my experience that civil injunctive and administrative proceedings could be, but were not necessarily, staffed by the Commission in different manners. Thus, the Trial Unit of the Division of Enforcement tries many of the SEC's civil injunctive actions, particularly those that are complex, or of great importance to the Commission's enforcement program, or both. In administrative proceedings, the staff that investigated the matter initially will often continue to be responsible for the proceeding. The General Counsel and the Trial Unit may, or may not, be involved in administrative proceedings, depending upon the complexity of the issues involved.

13. There are no Commission rules or other rules that prescribe the contents of the order that commences an administrative proceeding. In SEC administrative proceedings, the Federal Rules of Civil Procedure relating to pleadings do not necessarily have to be followed; in civil injunctive actions, however, the Federal Rules of Civil Procedure must be strictly observed. Therefore, in practice, in administrative proceedings, there may be abbreviated allegations that do not contain the detail that would be required in a federal civil injunctive action, in which, for ex-

ample, any alleged fraud must be set forth with particularity.

14. In addition, after an administrative proceeding has commenced, there is normally considerably less discovery than would obtain in a civil injunctive action.

15. The Commission requires, as it must, a waiver of the rules against separation of functions that apply to its administrative proceedings before the SEC will consider offers of settlement in administrative proceedings. It does not require such waivers in civil injunctive actions. I believe that such a waiver is required in administrative proceedings because, if the settlement does not become effective, the Commission does not want the knowledge of the case that is gained in connection with the attempt to settle the matter to interfere with its future decision-making role in such a proceeding. In civil injunctive actions, this problem does not arise, because the Commission is not the decision-maker.

16. In civil actions, the Commission may have considerable influence over various decisions during the action. The staff may, and in some instances must, approach the Commission with certain issues including whether to invoke a privilege, whether to appeal a result that is adverse to the Commission's position, and whether to abandon certain claims at trial or to amend a complaint to add new claims. The Commissioners may, although they rarely do, also participate in settlement negotiations with the party that is the subject of an SEC civil injunctive action, and decide whether to settle the action. The Commission may also decide whether to appeal a case or to accept the judgment of the trial court. Usually, the staff prepares a memorandum to the Commission that analyzes the issues and the Commission reviews such memorandum and bases

its decision thereon. In the process, the Commission gains extensive knowledge of the status of the case. Based upon my experience, the staff does not approach the Commission with any of these issues in an administrative proceeding, because the Commission is the appellate tribunal before which the proceeding pends, and it must remain impartial.

17. Similarly, the *ex parte* contact rules embodied in the Administrative Procedure Act apply to SEC administrative proceedings; they do not apply to civil litigation in which the SEC is a party.

18. The Commissioners have, from time to time, been subject to discovery, as parties, in civil litigation. I do not believe that the Commissioners could be, or ever have been, subject to discovery in an administrative proceeding.

19. At the time that I was at the Commission, there were internal memoranda that set forth guidelines for the preparation of staff enforcement recommendations, and whether an administrative hearing should be public rather than private.

20. I have no doubt that the role of the Commission in civil injunctive actions differs from its role in administrative proceedings. I do not believe that the Commission functions as it does in civil injunctive actions in any of its other decision-making responsibilities. However, in its rule-making capacity, the Commission functions in a manner analogous to the way it functions in administrative proceedings.

IV. Conclusion

21. Based on my knowledge and experience, the statements above reflect my opinions as to the distinctions

between the Commission's role in civil actions and administrative proceedings.

FURTHER AFFIANT SAYETH NOT.

/s/
Harvey L. Pitt

Washington, D.C.
Subscribed and sworn to
before me this 26th day of
February, 1988

/s/
Notary Public

My Commission expires: July 14, 1992

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 83-K-668

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

BLINDER, ROBINSON & CO., INC.,
MEYER BLINDER, and
LARRY BLINDER,
Defendants.

RECOMMENDATION
BY UNITED STATES MAGISTRATE

The matter before the court is the Motion for Sanctions filed by defendants Blinder, Robinson, & Co., Inc., Larry Blinder, and Meyer Blinder on November 17, 1987. Pursuant to Rule 602(A), Local Rules of Practice of this court, the matter was referred to Magistrate Hilbert Schauer for the purpose of hearing non-dispositive and discovery motions, as well as to conduct a settlement conference. Defendants seek sanctions against plaintiff United States Securities and Exchange Commission ("SEC") for its alleged failure to comply with discovery orders as follows:

1. Dismissal of the SEC's amended complaint.
2. Costs and attorney's fees incurred by defendants.
3. Entry of an order prohibiting the SEC from using any documents or testimony obtained or orders entered in

this case in any administrative or adjudicative proceeding against defendants.

4. Issuance of an order to show cause why the SEC, appropriate counsel, and Michael Macchiaroli (a former expert witness for the SEC) should not be held in contempt of court.

The motion was fully briefed and a hearing was held before the undersigned on November 25, 1987. After careful examination of the pleadings, relevant documents, and consideration of oral arguments advanced, the undersigned enters the following recommendation.

The events underlying this motion are somewhat complicated, and thus a chronology is both helpful and relevant to the issues addressed by this recommendation. Michael Macchiaroli, an SEC employee, was designated in March, 1986, as an expert witness by the SEC. His deposition was held August 4 and 5, 1987. During the first day of the deposition, counsel for the SEC refused to allow Macchiaroli to answer certain questions. The attorneys contacted the undersigned by telephone and, after a short discussion, counsel for the SEC was directed to allow Macchiaroli to answer. Notwithstanding the ruling, Macchiaroli was not permitted to respond to the questions.

The SEC thereafter sought reconsideration of the August 4 order. After two extensions of time, a Motion for Reconsideration was filed with the district judge on September 9. The motion raised issues as follows: First, that defendants were attempting to proceed beyond the scope of the order entered December 29, 1986, by the Honorable John L. Kane, District Judge, allowing limited additional discovery and that under the order, defendants could not attempt to elicit information in support of affirmative defenses that allegedly had not been pursued before the discovery cut-off date. Second,

that defendants' inquiry sought irrelevant information. Third, that the information sought was protected by governmental, deliberative process, attorney-client, and work-product privilege. The motion was denied on September 10, and the SEC was directed to file any requests for clarification with the undersigned.

The SEC then filed, on October 1, a pleading entitled "Motion for Clarification of August 4 Order of Magistrate Concernning Discovery." The motion essentially raised the same arguments made in the earlier Motion for Reconsideration.

Defendants issued a subpoena duces tecum to Macchiaroli on August 5, requesting him to produce certain documents relating to the areas of inquiry addressed by the August 4 order. By agreement of the parties, the subpoena was returnable on September 10. On September 9, the SEC responded by filing a Motion for Protective Order and to Quash a Subpoena. On October 8, the SEC filed a second Motion for Protective Order and to Quash a Subpoena, responding to a second subpoena duces tecum issued October 6, identical to the one issued on August 5. As with the Motion to Clarify, both of the motions addressed issues previously raised in the earlier Motion for Reconsideration. Additionally, the motions alleged that the subpoenas were overly broad and burdensome. The Motion for Clarification and the Motions for Protective Order and to Quash a Subpoena were denied after a hearing before the Magistrate on November 2.

Defendants re-noticed Macchiaroli's deposition on November 2, and issued another subpoena duces tecum, seeking the same documents requested by the earlier subpoenas. The deposition was to be held on Novemer 13. On November 12, the SEC filed a Motion to Delay an Appearance and for Protective Order and to Quash a Subpoena, and also a motion for extension of time to seek reconsideration of the November

2 order issued by the undersigned. The motion for extension of time and the Motion to Delay Appearance were denied on November 13, and attorney's fees were awarded to defendants pursuant to F.R.C.P. Rule 11 and Local Rule 602(C). In addition, the SEC was ordered to produce Macchiaroli and the documents on or before November 17 and counsel was informed that if that was not done, the undersigned would recommend that the case be dismissed.

Instead of seeking reconsideration before the district court of the November 13 order, the SEC filed two motions. On November 16, it filed a Motion to Amend Plaintiff's Witness List to delete Macchiaroli as a witness. On the same day, counsel for the SEC informed opposing counsel by letter that "[b]ecause we (the SEC) do not intend to use Mr. Macchiaroli as an expert witness, we have no obligation to produce him or the documents called for in your subpoenas to him." (Exh. E, Defendants' Memorandum of Law in Support of its Motion for Sanctions). The Motion to Amend Plaintiff's Witness List was granted by the district court judge on November 17. The second motion was a pleading entitled "Motion to Amend the Court's November 13 Order," and was filed by the SEC November 17. That motion requested that the SEC be relieved of the duty to produce Macchiaroli and the documents because Macchiaroli was no longer a witness. The motion was denied by the undersigned at the hearing held November 25.

Defendants filed the Motion for Sanctions on November 17. They argue as follows: The SEC willfully disobeyed a clear court order to produce Macchiaroli and the documents and that at no time did the SEC ever intend to comply with the order. They further state that the Motion to Amend Plaintiff's Witness List and Motion to Amend the Court's November 13 Order were merely attempts to circumvent the order requiring the production of the documents and the appearance

of Macchiaroli. Defendants assert that the actions of the SEC constitute a course of conduct designed to deny them access to relevant evidence while at the same time gathering material to be used in administrative or adjudicative proceedings against defendants. Defendants allege that Macchiaroli's testimony and the documents requested by the subpoena are relevant to defendants' affirmative defenses and case in chief, and would also have helped support defendants' motion for summary judgment. Defendants argue that the SEC's actions are such that imposition of sanctions pursuant to rule 37(b), the inherent powers of the court, the court's power to do equity, and the court's contempt authority are appropriate.

The SEC's response is that at all times it was acting in good faith and was trying to allow the case to go to trial as scheduled. It asserts that it believed that the primary basis for the Magistrate's order to produce Macchiaroli and the documents was Macchiaroli's expert witness status and that once he was withdrawn, there was no need to produce him or the documents. Counsel stated that the SEC chose not to seek reconsideration before the district court of the November 13 order issued by the undersigned because it wished to go to trial on schedule. The SEC contends that it believed in good faith that it discharged its obligations to produce Macchiaroli and the documents by notifying the court and opposing counsel of its intention to withdraw Macchiaroli and filing the Motion to Amend Plaintiff's Witness List and the Motion to Amend the Court's November 13 order. In addition, the SEC again raises arguments previously presented to and rejected by the court: that the scope of the testimony sought at deposition and documents requested by the subpoenas duces tecum were outside the limits of the December 29, 1986, order entered by the district judge, that defendants had abandoned their affirmative defenses and could not now try to resurrect them, and that Macchiaroli had no relevant testimony to provide.

DISCUSSION

The courts have wide authority to impose appropriate sanctions for failure to comply with discovery orders. Rule 37(b) allows the court to impose such sanctions "as are just," including those ranging from attorney's fees to contempt or dismissal of the action. In addition, the courts have ". . . inherent power to impose a variety of sanctions on both litigants and attorneys in order to regulate their dockets, promote judicial efficiency, and deter frivolous filings." *Betz v. United States,* 753 F.2d 834, 835 (10th Cir. 1985). In *State of Ohio v. Arthur Andersen and Co.,* 570 F.2d 1370 (10th Cir. 1978), the Tenth Circuit stated:

> Rule 1, F.R.Civ.P., provides that the Rules 'shall be construed to secure the just, speedy, and inexpensive determination of every action.' The trial courts must administer the rules to attain the proclaimed objective. (Citation omitted.) Enforcement of the rules requires sanctions for disobedience of valid court orders.

Id. at 1376. Without the power to sanction, the court's discovery orders would be meaningless. *Donovan v. Gingberbread House, Inc.,* 106 F.R.D. 57, 58 (D. Colo. 1985).

The sanction of dismissal is a severe one and should be employed cautiously. The Supreme Court stated in *Societe Internationale Pour Participations Industreilles Et Commerciales, S.A. v. Rogers,* 357 U.S. 197 (1957): "[R]ule 37 should not be construed to authorize dismissal . . . when it has been established that failure to comply has been due to inability and not to willfulness, bad faith, or any fault of petitioner." *Id.* at 212. In the proper case, the sanction of dismissal serves an important function:

> [T]he most severe in the spectrum of sanctions provided by statute or rule must be available to the

> district court in appropriate cases, not merely to penalize those whose conduct may be deemed to warrant such a sanction, but to deter those who might be tempted to such conduct in the absence of such a deterrent.

National Hockey League v. Metropolitan Hockey Club, 427 U.S. 639, 643 (1976). In that case, the court upheld the district court's order of dismissal where the district court found that the disobedient party had exhibited " '. . . callous disregard of responsibilities counsel owe to the Court and to their opponents.' " *Id.* at 640, (quoting: *In Re Professional Hockey Antitrust Litigation,* 63 F.R.D. 641, 656 (E.D. Pa. 1974)).

The case of *Sperandeo v. Milk Drivers and Dairy Employees Local Union No. 537,* 334 F.2d 381 (10th Cir. 1964) is particularly apt to the case at bar. There, the Tenth Circuit upheld the district court's dismissal, for failure to comply with an order requiring production of allegedly privileged documents for *in camera* inspection, of an action seeking an injunction brought by the National Labor Relations Board ("NLRB") against a union. The NLRB refused to produce the documents unless it could reserve the right to decline to produce any documents it felt were privileged, even if the court ordered production. The district court dismissed the case, and the Tenth Circuit affirmed, stating that the NLRB

> . . . is in no different position than any ordinary litigant and is, therefore bound by the discovery provisions of the Federal Rules of Civil Procedure in the same respects as any ordinary litigant. . . . It is for the Court, and not the governmental agency or executive branch, to determine whether documents sought to be withheld under a claim of privilege are entitled to the protection of that privilege.

Id. at 384. See also: *Kahn v. Secretary of Health, Education, and Welfare,* 53 F.R.D. 241, 244 (D. Mass. 1971).

After a careful review of the file and the numerous hearings held in this matter, the undersigned determines that the record supports the following findings and conclusions.

The SEC deliberately failed to comply with a clear court order and has not proceeded in good faith. The SEC was directed to produce Macchiaroli and the documents requested by the subpoena duces tecum on or before November 17, 1987. This was not done. The failure to comply was the result of a conscious decision, and not due to any negligence or inability on the SEC's part. Counsel for defendants asserted, without contradiction, that the SEC voted twice not to produce the documents or allow Macchiaroli to testify. This assertion is supported by the Affidavit filed by Jonathan Katz, Secretary of the SEC, stating that Macchiaroli was directed by the SEC not to testify as to the subject matter propounded by defense counsel and as was required by court order. (Exh. C, Defendants' Reply to SEC's Response to Defendants' Motion for Sanctions.) As counsel for defendants pointed out, when the November 13 order was entered, the SEC had only two choices: comply or seek reconsideration from the district judge. The SEC did neither.

The SEC asserts that it believed that the withdrawal of Macchiaroli as a witness and the Motion to Amend the Court's Order of November 13 (hereinafter "Motion to Amend") relieved it of the duty to comply with the order. This is not the case. The Motion to Amend was inappropriate, and it was denied as such by the undersigned at the November 25 hearing. No legal authority supporting the SEC's belief was ever cited, and the Magistrate's conclusion is that no authority exists which allows a litigant to unilaterally decide that a court order no longer has force or effect. The SEC's refusal to pro-

duce Macchiaroli was the result of a decision by the SEC, not the court. The fact that the Motion to Amend Plaintiff's Witness List was granted did not entitle the SEC to assume that it would no longer be required to comply with the order. In making the assumption that it did, the SEC was, in effect, substituting its judgment for the court's. As stated in *Sperandeo, supra,* this is not proper. Such behavior is a cause for grave concern because the basic principles underlying the judiciary do not allow the executive branch to overrule the courts in matters properly within the courts' jurisdiction. See: *United States v. Nixon,* 418 U.S. 683, 703-05 (1973); *Sperandeo,* 334 F.2d at 384.

The record is clear that the SEC never intended to produce Macchiaroli or the documents. The SEC made no assertions, and there is nothing before the court to indicate, that any effort was made to begin compiling the documents requested by the subpoena. It is readily apparent that the efforts of the SEC were directed towards non-compliance when they should have been directed towards production.

The record also discloses a ". . . pattern of evasion intended to obstruct the juducial process and deprive (defendants) of a judicial determination of (their) claim(s)." *Kahn v. Secretary of Health, Education, and Welfare,* 53 F.R.D. at 245. The SEC engaged in a pattern of last-minute or untimely filings in connection with this matter epitomized by the filing of the SEC's Motion to Amend Plaintiff's Witness List and Motion to Amend. The Motion to Amend the Plaintiff's Witness List was not filed until the *day before* the production of Macchiaroli and the documents was to take place. The Motion to Amend was not filed until November 17, the last day for the production of the documents and the appearance of the witness. Another example of the SEC's dilatory behavior is found in its filing of two motions late in the afternoon of November 12, the day

before Macchiaroli's deposition was scheduled (this date was vacated) and exactly ten days after the November 2 hearing before the Magistrate. The first motion requested an extension of time to seek reconsideration of the undersigned's November 2 order. The second requested that any further discovery of Macchiaroli be stayed until the parties' motions for summary judgment had been ruled upon (although the SEC had not yet filed its cross-motion for summary judgment). Both motions were filed at the last possible minute, and the explanations of the reasons for the untimeliness by counsel were wholly unconvincing. Both motions were denied. Filings at such a late date in an important matter in the case, with the trial date so near, strongly refute the SEC's assertions of good faith.

It was not the first time that the SEC withdrew a witness scheduled for deposition by defendants. Mary Lucille Strawn, director of consumer affairs at the SEC's Denver regional office, was an SEC witness whose deposition was noticed by defendants on December 29, 1986. Defendants asserted, without contradiction by the SEC, that she was withdrawn when defendants scheduled her deposition. Although not controlling as to the ruling in this case, this and other actions by the SEC compel the conclusion that it was the SEC's intention to deny defendants access to information reasonably calculated to lead to the discovery of admissible evidence.

Even assuming, as argued by counsel for SEC, that the improper course of conduct was not undertaken by design, it certainly produced the same result with the same prejudice to the defendants. The misconduct in this case is much like that encountered by the court in *Sperandeo, supra,* and faced by the SEC in the case of *SEC v. First Financial Group of Texas,* 659 F.2d 660 (5th Cir. 1981). In *First Financial,* the Fifth Circuit upheld the district court's entry of default judg-

ment and order holding defendants in contempt for their failure to comply with discovery orders. A passage from the SEC's brief on appeal in that case describing the conduct of the disobedient parties applies to the conduct of SEC in this case:

> In its February 15, 1980, order granting the Commission's motion to compel discovery and directing Messrs. Reynolds and Howton to appear and testify before the magistrate, the district court served ample notice on them that if they persisted in their complete disregard for the rules of discovery and the court's orders, the court would entertain motions for the more extreme sanctions under Rule 37(b) of the Federal Rules of Civil Procedure. Their conduct in the face of that admonition fully warranted the district court's exercise of its broad discretion to enter orders of permanent injunction and of contempt against them.

(Page 18, Exhibit B to Defendant's Reply to Plaintiff's Response to Defendant's Motion for Sanctions.) In the case at bar, the SEC was put on notice of the consequences of failure to produce Macchiaroli and the documents on or before the date ordered. The SEC consciously embarked on a course of conduct that placed its judgment above that of the court, and involved refusal to comply with a clear court order. Under such circumstances, the sanction of dismissal is appropriate. Furthermore, defendants' requests for attorney's fees and costs and entry of an order precluding the SEC from using testimony or documents obtained or orders entered in this case in any administrative or adjudicative proceeding against defendants have merit and it is recommended that they be granted as a sanction pursuant to F.R.C.P. Rule 37(b). With regard to defendants' request that the court enter an order to show cause why the SEC, appropriate counsel, and Mr. Michael

Macchiaroli not be held in contempt of court, the Magistrate concludes that while the actions in this matter were improper, the sanctions recommended herein are sufficient, and it is therefore the Magistrate's recommendation that no order to show cause be issued.

IT IS THEREFORE RECOMMENDED that this case be dismissed.

IT IS FURTHER RECOMMENDED that the SEC be precluded from using any testimony or documents obtained in this case, as well as any orders entered in this case, in any administrative or adjudicative proceeding against any of the defendants.

IT IS FURTHER RECOMMENDED that attorney's fees and costs be awarded to defendants.

IT IS FURTHER RECOMMENDED that defendants' request that an order to show cause why the SEC, appropriate counsel, and Mr. Michael Macchiaroli not be held in contempt of court be DENIED.

FURTHER, IT IS ORDERED that under Rule 602 C of the Local Rules of Practice of the United States District Court for the District of Colorado, the parties shall have ten (10) days after the service hereof to serve and file any written objections in order to obtain reconsideration by the Honorable John L. Kane, Jr., District Judge, to whom this case is assigned.

DATED at Denver, Colorado, this 2nd day of December, 1987.

BY THE COURT:

/s/ Hilbert Schauer
Hilbert Schauer
United States Magistrate

UNITED STATES MAGISTRATE
UNITED STATES DISTRICT COURT
UNITED STATES COURTHOUSE
DENVER, COLORADO 80294

HILBERT SCHAUER (303) 844-2117

Civil Action No.: 83-K-668

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I hereby certify that I have mailed or hand-delivered a copy of the attached to the persons listed above on Decemer 2, 1987.

/s/
Deputy Clerk to Magistrate Schauer

FILED
U.S. DISTRICT COURT
DISTRICT OF COLORADO

87 DEC 2 P3:48

JAMES MANSPEAKER
CLERK
BY /s/ Sh DEP. CLK.